January 1957

THE CANADIAN CHARTERED ACCOUNTANT

THE CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS

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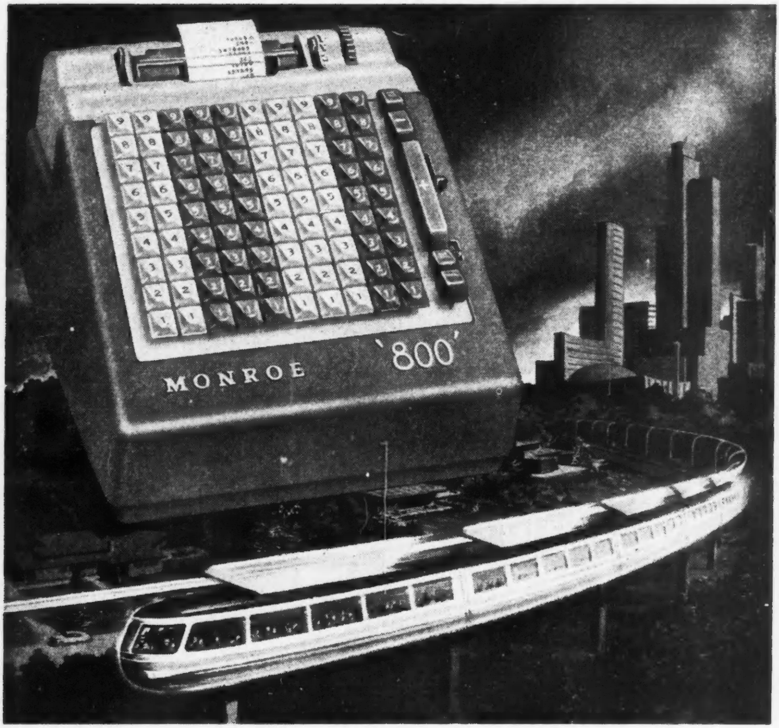
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CHARTERED ACCOUNTANT

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EDITORIAL

ARTICLES

DEPARTMENTS

MONTHLY FEATURES

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IN THIS ISSUE

L. J. LACEY

Electronic computers still remain a mystery to many people who are inclined to put them in a class with Frankenstein's monster. As these machines continue to develop, their commercial impact will be felt more and more and there seems little reason to doubt that during the next five years these giant brains will bring further rapid technological advances. In "A Review of E.D.P. Equipment", Leo Lacey considers the principal characteristics of the various types of electronic equipment which are available in Canada – and what such equipment can do is astonishing.

Mr. Lacey is associate director of electronics with the management advisory services group of Price Waterhouse & Co. He was formerly in charge of the electronic data processing study group of the Hydro Electric Power Commission of Ontario. A graduate in mathematics of the University of London and a member of the Association of Professional Engineers of Ontario, Mr. Lacey is the author of a number of technical articles and papers, including a standard text book on geometry. His article is another in the series of articles on I.D.P. and E.D.P. which will continue to be published in *The Canadian Chartered Accountant* during the first half of 1957.

W. AITKEN, F.C.A.

Second only to forest products in Canadian export values, grains are currently moving at a steady pace in international trade. In fact, the grain industry may well be called a fundamental of the Canadian tradition. In "Grain Exporters and Shippers Accounts", William Aitken deals with the essential factors involved in the grain exporting and shipping business. After discussing the conditions under which agreements are entered into to regulate export sales, he turns his attention to a thorough and detailed description of the grain movement and related matters.

Mr. Aitken has been a partner in the firm of Glendinning, Jarrett and Campbell of Winnipeg since 1947. His experience in the grain business has been extensive, having previously served in executive positions with the Canadian Wheat Board for 12 years and with the grain marketing agency of the Federal Government for four years. He is a member of the Institutes of Chartered Accountants of Manitoba and Alberta and a past president of the Manitoba Institute. He is a former president of the Winnipeg Chapter of N.O.M.A. and of the Society of Industrial and Cost Accountants of Manitoba.

C. L. KING, F.C.A.

The special need for the development of a program of recruitment, staff training, testing and post-graduate education has been occupying the attention of the Canadian Institute of Chartered Accountants and the Provincial Institutes for the past several years. In "Attracting Students to the Profession", Clem King summarizes the recommendations made by the C.I.C.A. Committee on Recruitment and Training as a result of an intensive study which began early in 1953. The report contains 21 recommendations and has been reviewed in detail by the Provincial Institutes. As a result of this study a start has been made to appraise in terms of man-

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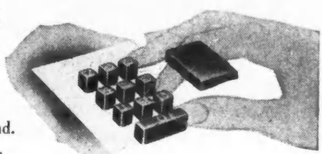

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power and education the progress of the profession up to now and how it can make the greatest contribution in the future.

Mr. King is a partner of Deloitte Plender Haskins and Sells of Toronto. He is well known to readers of *The Canadian Chartered Accountant* as former executive secretary of the Canadian Institute, a position he held from 1946 until 1954. Mr. King received his certificate of chartered accountancy in 1940 and ten years later, as a member of the Institute of Chartered Accountants of Ontario, was made a Fellow of that Institute. He is vice-president and treasurer of the Ontario Division, Canadian Cancer Society.

DANIEL W. CASEY

At the end of September 1956 loans in Canada of all chartered banks totalled five billion dollars, not including advances to governmental bodies, investment dealers or mortgage loans under the National Housing Act. This figure is an impressive indication of the extent to which Canadian business seeks the assistance of the banker.

Daniel W. Casey, in "The Auditor and the Banker in the Credit Picture", emphasizes the need of good audit reports and close working relations between bankers and accountants. He discusses in some detail the main considerations in the appraisal of credit applications and indicates that the threat of inflation demands that the banks act with considerable caution for the sake of the country as a whole as well as of their own and clients' interests.

Mr. Casey has had many years experience in the banking business. Currently chief inspector of the Bank of Montreal, he joined the Bank in 1928 and has served at numerous branches in the Maritimes, eastern and western Canada. Prior to his present appointment Mr. Casey was superintendent of the Bank of Montreal's Manitoba and Saskatchewan district.

GEORGE G. RICHARDSON, F.C.A.

The basic issues discussed in "Taxes —Accumulation of Undistributed Income, Consolidations and Mergers" are important to many businessmen. So long as Canada imposes taxation at both corporate and personal levels, problems relating to undistributed income will always arise. The article by George G. Richardson is a digest of a paper he presented at the summer Tax Seminar held at Queen's University, Kingston. Reorganization of corporations in financial difficulty or that require a readjustment of their share capital structure involve many considerations and the author draws upon a broad background of experience in bringing his readers in touch with some of the problems.

Mr. Richardson is a partner of Clarkson, Gordon & Co., of Toronto with whom he has been associated for the past 30 years. He is a former chairman of the C.I.C.A. Committee on Accounting and Auditing Research and a past governor of the Canadian Tax Foundation. For his services to the profession he was made a Fellow of the Institute of Chartered Accountants of Ontario in 1953.

EDITORIAL

"Whenever a chartered accountant engages a student he makes a decision which affects the entire profession, for the student of today is the chartered accountant of tomorrow". This month's editorial by T. C. Kinnear, F.C.A., from which the foregoing is an extract, is suitably called "One Soweth and Another Reapeth". The ac-

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counting profession can be only as good as the people of whom it is made up. There is a shortage of accounting talent of sufficiently high intellectual quality to meet the growing demands, Clark Kinnear feels and he makes some specific and realistic suggestions on how to improve the situation.

Mr. Kinnear is a partner in the Toronto offices of Price, Waterhouse & Co., having recently completed 23 years service with his firm. As chairman of the C.I.C.A. Committee on Recruitment and Training, he has been particularly concerned with the future of the profession in this field. He is at present a member on the Council of the Institute of Chartered Accountants of Ontario and has served on a number of important committees of that Institute.

FORTHCOMING FEATURES

ACCOUNTING IN THE CONSTRUCTION INDUSTRY
W. M. Karney

REGULATORY CONTROL OF PUBLIC UTILITY RATES
Ross Skinner

AUDITING ELECTRONICALLY PRODUCED RECORDS
J. R. Murray

DEVELOPMENT OF MUNICIPAL GOVERNMENT IN CANADA
K. G. Crawford

INTERNAL CONTROL AND THE AUDIT
W. E. Shields

NOTES AND COMMENTS

A RECORD NUMBER of new chartered accountants are joining the ranks of the profession. The results of this year's examinations show that out of 927 final candidates, 527 passed and 103 obtained supplemental standing. A total of 1,775 students wrote the examinations across Canada. Of 848 intermediate candidates, 488 passed.

The Governor-General's gold medal for the highest average standing on the final six papers, which carries with it a cash prize and an all-expense-paid trip to the C.I.C.A.'s annual meeting (in Saskatoon next August), was won by Edwin C. Harris, Halifax, N.S. Born in Saint John, N.B., Mr. Harris received his public and high school education in that city and won an entrance scholarship to Dalhousie University. He was selected in 1953 to represent Dalhousie at the World University Service Seminar in Mysore, India. He graduated in Commerce in 1954 and articled with the firm of Lee & Martin in Halifax. He has now returned to Dalhousie University to secure a degree in law.

Ronald E. Gallay of Montreal and Marc-Edouard Martel of Quebec City tied for the C.I.C.A. silver medal, which is awarded to the senior candidate with the second highest marks. The former was educated at Montreal High School and obtained his B.Com. degree in 1954 at McGill University. He is with the Montreal firm of Weinstein, Fox & Bessner. Marc-Edouard Martel was born in Courville, Quebec. He attended the Academie de Quebec, from which he graduated with a B.A., and later obtained the degree of Master of Commercial Sciences at Laval University. He is with McDonald, Currie & Co., Quebec City.

Top marks in the intermediate examinations, and the C.I.C.A. silver medal for this achievement, went to Irving L. Rosen, now with Pape, Pape, Strom, Sherman & Fisher of Toronto. He is a graduate of Harbord Collegiate Institute, Toronto, and in the Grade XIII examinations wrote ten papers and secured ten firsts.

E. C. HARRIS
Gold Medal

R. E. GALLAY
Silver Medal

M.-E. MARTEL
Silver Medal

I. L. ROSEN
Silver Medal

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Winning Canadian Reports

For the past six years *The Financial Post* has sponsored awards for the best annual reports published by Canadian companies. Results of the 1956 contest have recently been announced. Winners in the Manufacturing and Processing – Metals and Metal Products section were Ford Motor Co. of Canada, Aluminium Ltd. and Massey-Harris-Ferguson Ltd. In the Primary Manufacturing and Processing group top awards went to Imperial Oil Ltd., Canadian Oil Cos. and MacMillan & Bloedel Ltd. In the Secondary Manufacturing and Processing group winners were Moore Corp., Chateau-Gai Wines Ltd. and Hiram Walker-Gooderham & Worts. Dominion Stores led in Retailing and Distributing, followed by Southam Co. and Famous Players Canadian Corp. For Mining and Oil Production awards were made to Steep Rock Iron Mines Ltd., Falconbridge Nickel Mines Ltd. and Asbestos Corp., and for Public Utilities to British Columbia Power Corp., Shawinigan Water & Power Co. and Bell Telephone Co. First in the Financial Institutions category were Industrial Acceptance Corp., Canada Life Assurance Co. and Toronto-Dominion Bank.

American Survey

The annual reports of American corporations are more informative and complete than ever before, according to the 10th edition of "Accounting Trends and Techniques", a 299-page book published by the American Institute of Accountants. This annual survey analyzes the reports of 600 typical industrial corporations and makes the following observations:

All but two of the 600 companies presented complete sets of balance sheets, income statements and surplus statements.

Only 59 of the companies failed to include footnotes to the financial statements explaining items on the statements or added significant data.

Statements in comparative form were presented by 78% of the companies, and 65% disclosed pension and retirement plans. There was a 27% increase in companies mentioning employee stock option plans.

Cash dividends were declared by 97% of the companies in 1955, compared with 93% in 1954.

The title "Profit and Loss Statement" has largely given way to such titles as "Income Statement", "Statement of Earnings" or similar designations. The term "Balance Sheet", while still used by the majority of companies, has lost ground to "Statement of Financial Position" or "Statement of Financial Condition".

Over half of the companies have dropped the term "earned surplus", preferring some form of "retained earnings".

Copies of "Accounting Trends and Techniques" may be obtained from the American Institute of Accountants, 270 Madison Ave., New York 16, N.Y. at $15 paperbound.

New Editors

Arthur E. Webb, assistant editor of *The Accountant* for the past seven years, has been appointed editor. He succeeds Derek du Pre who resigned this post in order to become joint secretary of the Institute of Cost and Works Accountants.

Dr. Emanuel Saxe, for many years editor of *The New York Certified Public Acountant*, has resigned in order to accept the post of Dean of the Bernard M. Baruch School of Business and Public Administration. He will be replaced by Benjamin Newman, presently Associate Professor at Adelphi College.

Editorial

ONE SOWETH AND ANOTHER REAPETH

INSUFFICIENCY IS probably the first thought which occurs when the subject of staff recruitment is considered. Were there not problems in obtaining staff the subject might receive but scant attention. Let us, however, reflect on another aspect of staff recruitment – the importance of whom we recruit – the quality aspect as it were, for in it may lie, in part, the solution to the sufficiency problem.

In the medical profession where, over the years, standards have risen to very high levels, there is no recruitment problem except to the would-be medical student who cannot meet the stiff entrance requirements of the medical schools. Notwithstanding the time required to qualify, the severity of the examinations, the relatively high cost of medical training, the subsequent period of internship, with the possibility of a further period of training as a specialist, the result has been that there are more applicants for medicine than there is accommodation. Two reasons suggest themselves: limitation of numbers and status. Limitation arises not through an arbitrary predetermined judgment of members of that profession but rather through the limitations in the availability of training facilities and the capacity of medical schools; status, because of deserved public respect and dependency.

Admitting that the standard of qualification in each profession is high and that the chartered accountant who has passed his final examination enjoys a sense of achievement and public recognition of his status, we can still afford to reflect with some envy upon the implications inherent in the sufficiency of medical students.

Historically we have had a rather high failure rate at the examination level which suggests inadequate selection methods of the recruit. The almost automatic admission of students having the necessary matriculation subjects with a minimal standing of less than

third class honours overall without application of any objective screening techniques does not constitute a high entrance standard. Psychologically we have made little attempt to create a demand by making it clear that only those with ability to succeed (so far as that can be measured in advance) can enter.

Whenever a chartered accountant engages a student he makes a decision which affects the entire profession, for the student of today is the chartered accountant of tomorrow, and we can only be proud of our profession tomorrow if we attract the best kind of student today. High school and university graduates who attain a good scholastic standing and the respect of their contemporaries are not behaving in an unreasonable manner if they expect a better financial reward than that offered to those who have barely succeeded. A premium in the commencing salary for a young man with a superior record and an outstanding potential may make the difference between his becoming a chartered accountant and being attracted elsewhere. Difficult though it may be to measure statistically, there is unquestionably a great variation in productivity of effort and work of individuals. Employers who maintain an inflexible starting salary may not only be paying a higher time cost but may shut the door to deserving applicants who pass by the profession because they receive greater financial recognition of their premium qualifications elsewhere.

It is a characteristic of the family institution to endeavour to improve the economic position of its progeny in society. There seems to be a lesson here for the profession. Few of us would not want to see the chartered accountant of the next generation occupy an even higher rung on the economic ladder than we enjoy, notwithstanding that generally chartered accountants already enjoy a relatively high standard of living. To bring about further improvement we must make every attempt to attract the best possible recruits, to provide them with the best possible training, both in the field and in their formal instruction. The tuition offered students today is superior to that offered a generation ago because we have continually striven to improve our instruction material and methods and we must look forward to improvements in the future. Much effort has gone into this aspect of the profession in the past and more will be required tomorrow. If we remain static we will shrink in relation to others, while if we follow a dynamic policy we should improve our relative position in the economic society. As we do, the demand for admission to the profession will increase.

The Auditor and the Banker in the Credit Picture

DANIEL W. CASEY

BANKERS DEPEND extensively on the work of auditors to assist them in their appraisal of credit applications. Were it not for the auditor's report, the banker would, in many cases, have no sound basis on which to formulate an assessment of a business as a banking risk.

The importance of the auditor's report to the bank may be taken as second only to its importance to the management of the business itself, providing as it does an independent check on the results of the company's operations. The auditor's report helps management to determine if the business is being conducted along sound lines, where weaknesses may lie, and in what direction solutions may be found for improvement. Information revealing such vital points in the company's operation is clearly as indispensable to the banker, if he is to work in the best interests of his client and of his institution.

At September 30, 1956, loans in Canada of all chartered banks totalled nearly five billion dollars, not including advances to governmental bodies, investment dealers or mortgage loans under the National Housing Act. Such borrowing is an impressive indication of the extent to which Canadian businesses seek the assistance of their bankers, and in this picture the auditor plays a major role in bringing about a satisfactory arrangement for both borrower and lender. The banker is ever-conscious of this, and there is growing evidence, from a perusal of reports prepared by chartered accountants, that the auditor takes far more than a passing interest in his clients' affairs, endeavouring to guide them in all matters pertaining to the financial end of the business. The auditor also can do much to influence management to discuss all features of the business, sound or otherwise, with the company's banker, who is normally in a position to give sound guidance based on his handling of credit problems of others engaged in similar lines or through his intimate knowledge of conditions in the immediate locality.

Financial Needs of Medium-Sized Businesses

Since it would be impossible to treat this subject exhaustively within the space limitations of a brief article, no attempt has been made to cover credit matters relating to the very small business or the very large corporation, believing that the reader

will be most interested in the medium-sized business.

The financial needs of such organizations divide themselves into two main categories:

1. Short-term loans for operating purposes.
2. Long-term funds for plant expansion or the acquisition of fixed assets.

The first consideration will be short-term borrowing, since the bank's normal lending function is for the financing of current operations. For the purpose of discussion, it may be assumed that a medium-sized business has been in operation some time and has an established banking connection. The company's banker will, through this association, have become well acquainted with his customer's affairs and will be in a position to deal with credit applications promptly, based on past performance, audited financial statements, and the prospects for the business in the immediate future.

Evaluation of the Management

Management of the business is one of the prime considerations in dealing with credit. It goes without saying that a business dependent on one man is vulnerable, as is a partnership, unless proper provision has been made for guaranteeing continuation of the firm in the event of the death of one partner. The banker must know the details of the partnership agreement and whether or not provision has been made through insurance or otherwise to ensure that the plan covered by the agreement can be carried out. Obviously, loss of the guiding hand in a one-man organization, or any upset to the business of a partnership through death or other causes, has the immediate effect of making the business less attractive as a credit risk.

The soundness of the management is, of course, a prime factor, when it is considered that more than 95% of business failures in Canada are attributable to managerial shortcomings. True, these shortcomings lead to weaknesses of a financial nature in one aspect or another, and financial causes might, on the face of things, be adduced as the reasons for failure, when actually the explanation lies in the incompetence or inexperience of the management.

Importance of Certain Balance Sheet Items

Inventory as disclosed in the balance sheet is the major item concerning which the banker must look beyond the auditor; he must have complete confidence that the borrower has declared the true position. It is well for the businessman and the banker to remember that, while liabilities must be met at their full dollar-value, the realization of an asset such as inventory will, if forced, almost invariably result in shrinkage. In manufacturing concerns it is of major importance to know that a proper balance is being maintained of raw materials, goods in process and finished stock. Although it is not the responsibility of the auditor to see that adequate insurance is in force, it is a matter on which he can — and in many cases does — offer sound advice to the principals of the business. Inventory reserves and the tax position in relation thereto are matters for consideration in extending credit.

Receivable difficulties — again generally the end-result of poor management — are one of the most common

causes for failure. Management, obviously, must constantly guard against this pitfall. An impressive sales record means little to the success of a business if the resultant increase in profits is sacrificed in an unsound credit policy leading to write-offs.

Accounts receivable are a common form of security for bank loans. As long as the banker is satisfied that adequate control is being maintained to ensure that an unduly large number of weak accounts do not creep in, he is willing, in most cases, to make advances against a pledge of these assets. This is not the heading under which amounts due by directors, shareholders, or employees should be shown, since, for the purpose of determining credit entitlement, the banker regards such items as falling into the deferred category unless they are independently and adequately secured.

Other liquid assets, such as cash and investments, usually are self-explanatory, although in the case of the latter particular care must be given to determining the liquidity. Investments in subsidiaries may not be readily realizable and other types of investments may be represented by equities which ultimately result in shrinkage of working capital.

Scrutinizing Fixed Assets

While the banker is immediately more concerned with the current position for determining the safety of loans, he nevertheless considers that the fixed assets must come in for close scrutiny. It may well be that excessive fixed assets, such as buildings and machinery, are carrying heavy set annual charges, which will ultimately jeopardize the survival of the company. Although there is no set ratio to determine what may or may not be too heavy an investment in plant, the banker would probably go into the matter more thoroughly if he saw that fixed assets represented more than say two-thirds of the tangible net worth.

It is almost a corollary that where fixed assets exceed tangible net worth there would be mortgages or debenture-debt if a liquid surplus is being maintained. The company is then saddled with a heavy annual charge for depreciation as well as a substantial commitment to meet interest on the long-term debt. These commitments, being more than the size the business can support, could lead quickly to failure under changing business conditions in which new competitive factors might result in lower sales or otherwise affect the profit picture.

Where a company, with heavy fixed assets, is too small to be attractive to an investor on a funded-debt basis, the debt load will probably show up in current liabilities to the point where trade payables cannot be met as they fall due.

Such factors are particularly important in these days when the desire to expand in a buoyant economy is only natural; but, if a business is to continue to be successful, careful thought must be given to all factors before embarking on an expansion program.

Comments on the Liabilities

With respect to liabilities, the banker is in a position to know if the loan to his customer is fluctuating properly; for example, advances to a firm which sells with a set billing date each month would decrease sharply after the collection date under normal circumstances. It is import-

ant for the banker to know that reduction of bank loans is not being accomplished merely by deferring settlement of trade payables; and this is something he can usually ascertain by a close examination of the day-to-day entries in the account, particularly those representing drafts charged.

Negligence in the matter of trade discounts or inability to take advantage of them can be costly to a business to an extent many businessmen do not realize. For bookkeeping purposes, trade credit involves no cost, but if such credit provides an alternative of discount for early settlement, then the business is jeopardizing its chances to make a reasonable profit if it allows the discount to pass. Terms of 2% 10 days, net 30 days, have one result if the discount is not taken: it means that the purchaser is paying 2% for 20 days' credit; and, on an annual basis, this means roughly 36%.

If there are amounts due to directors, shareholders or employees which may represent loans to the business, undrawn dividends or salaries, the banker will wish to know the plans for payment. The sudden withdrawal of such moneys, if of a substantial amount, could easily be the cause of serious difficulties, and the lending institution might want a definite understanding that no withdrawal takes place during the currency of its loans to the company.

A bond issue in the deferred liabilities will require scrutiny by the commercial lender, since the terms of repayment, carrying charges, etc., will have a bearing on future operations. The trust deed may include conditions which will preclude the company from using its liquid assets freely as support for current loans — a situation that is hardly attractive to the banker who may require dependence on inventory or receivables for protection of his position.

The foregoing, being simply comments on balance-sheet items at a given date, are not in themselves conclusive on any point, and, in the light of this, the banker must use the operating statements and annual comparisons of balance sheets as the basis for determining trends. It is by this use of audited statements that points of weakness or strength may be disclosed. Heavy changes in items in these statements, placing them out of line in relation to their standing of previous years, will probably explain much in regard either to success achieved or to difficulties encountered.

Working Capital Position

Working capital is usually the most important factor in determining the extent to which a bank may safely lend. In the past ten years of an expanding economy the time-honoured principle of two-to-one ratio in current assets to current liabilities has been, to a large extent, forgotten. Before the war, it was normally considered that bank advances equal to working capital could be taken as reasonably safe. Now, however, we find many instances where bank loans are on a much slimmer basis and, in certain types of business, where working capital is non-existent. One group in the latter category is the construction business, where successful operations may depend to a greater extent upon fixed assets, such as equipment, without which contracts could not be carried out. In such cases the banker may well be satisfied, so long as the company has a good equity in fixed assets, to make

current loans against the value of work completed, even though current liabilities may be running at about the same level as current assets.

One statement, included in the reports of some auditors, is particularly useful to the banker. This is the "application of funds" or, as it is sometimes called, "changes in working capital". It tells at a glance just what has occurred during the year to bring about the rise or fall in the liquid surplus, and it enables the person reviewing the statement to follow up what may be considered weaknesses in management's handling of company affairs.

Bank loans may also be made on a basis having little relation to the balance sheet, if independent security or guarantees of principals can provide undoubted support. There is, of course, little to be said on such cases, because, while the successful operation of the business is important from the standpoint of those supporting it, safety of the bank's depositors' funds is provided regardless of the outcome.

Thus far, we have been dealing with factors as they stand at a given time. Some managements, unfortunately, look no farther ahead than the current operating period, lacking, as they do, adequate planning in their long-term operation. The forehanded determination of policies which will see a business through good times and bad, is, of course, the mark of capable management. Naturally, evidence of this quality, proved through past performance, will mean much to the commercial banker.

Long Term Loans

At the outset, we spoke of financial needs of the medium-sized business as falling into two categories, the second of which was the requirement of long-term funds for plant expansion or the acquisition of fixed assets. Prior to the last war, it was not considered the function of a bank in Canada — precluded, as it was, from taking mortgage security — to provide assistance of this nature. Following the war, however, the re-tooling of plants for commercial production did bring about demands, particularly in the small and medium-sized organizations to whom the availability of funds through bond issues was not open, which the banks felt it was necessary to meet where justified. As a consequence, term loans came into being, running five to seven years in most cases. The results were uniformly satisfactory, though it must be remembered, of course, that business was favoured throughout the entire period by a steadily improving economy. The form of security taken in these cases varied, but, generally speaking, wherever a charge over the fixed assets was considered a necessity, a trust indenture with bond issue provided the vehicle for lending.

The threat of inflation demands that the banks act with considerable caution from time to time for the sake of the country as a whole, as well as in their own and their clients' interests. While the chartered banks in Canada do not originate credit control, they must chart their own operations to keep within the limits which are desired or set by official monetary policy. This has happened on two occasions since the last war: one, roughly five years ago when consumer credit restrictions actually were enforced; the other, during the last year. The chartered banks, after full study of the matter with officials of the Bank of Canada, decided it was only prudent to place some restrictive

measures on credit, and it is natural that this should affect first of all the attitude toward long-term loans.

Sources of Funds for Expansion

With activities in this direction curtailed, the businessman must look to what actually is the more proper source of such funds for plant enlargement.

First of these sources is entirely internal, being the retention of profits. Secondly, the owners may decide that injection of additional permanent capital is required, a course which is in line with earlier remarks that investment in fixed assets should not loom too large in relation to tangible net worth. Again, there are the mortgage-lending channels and also the services of the Industrial Development Bank to explore for such assistance. Additional equipment may be financed through extended credit terms by sellers, or alternatively by a finance company. It is essential, however, that the increased profits expected through the use of the equipment are sufficient to justify what may be considered heavy carrying charges for financing.

Canada's economic life has, until recent times, been marked by periods of boom and depression. In late years, by contrast, there has been an ever-expanding economy not subjected to the vagaries of marked contraction. The banks had to adjust to the ups and downs of former days, and in so doing they were frequently criticized as being the cause of depressions. Far from this being the case, the banks' actions were merely self-protection in a period of falling demand, and it may be said to the contrary that bankers frequently foresaw the end of a rising spiral and did much to place their customers on guard against adopting further expansion policies.

Harmony among Banker, Customer and Auditor

Business in Canada has enjoyed a long period of prosperity which has been shared by the banks. With 1956 showing further record achievements and the outlook for the year ahead promising, there is no reason to anticipate any marked adverse swing.

The prosperity of our country and business generally finds confirmation in the very low rate of business failures during the past ten years. This seems to be a fair indication that business loans made by banks have been well justified, reflecting a good measure of understanding and harmony in the relationship between customer and banker, a relationship in which the auditor has played no small part.

Attracting Students to the Profession

C. L. KING

THE EXTRAORDINARY economic growth of Canada which has continued since World War II has brought problems as well as prosperity. By the latter part of the 1940's the accounting profession was experiencing an acute shortage of student personnel, notwithstanding an annual student enrolment at a much higher level than ever before. The profession realized that one of the reasons for this shortage was the ever increasing number of students required by the professions and business each year. They realized also that the birthrate during the depression 30's was unduly low and that there was a proportionately smaller percentage of the total population from which to draw student recruits than before the war.

After considerable discussion among the various Institutes across Canada it was decided in 1951 to appoint a special committee to study the matter and thus assist in bringing about such changes as might be necessary to place the accounting profession in the best possible long-term position, to attract its full share of desirable students and to train them as effectively as possible. At its 1951 annual meeting the Council of the C.I.C.A. appointed George C. McDonald, C.A., of Montreal as chairman of a special Committee on Recruitment and Training. The terms of reference of this committee were:

(a) *Recruitment*:

To investigate the situation in the various provinces of Canada with respect to applicants for entry into the accounting profession with particular reference to:

1. the sufficiency in numbers of such applicants
2. their educational background
3. quality of applicants in comparison with persons being recruited into other professions and larger business organizations.

(b) *Training*:

To consider generally the effectiveness of the systems of instruction, examination and service requirements in force in the Canadian provinces:

1. in relation to the numerical needs of professional practice and the demands of the business community
2. in attracting and training the class of person most likely to make a success of a career in accountancy.

(c) *Additional Recommendations*:

With a view to ensuring a permanent supply of suitable applicants for entry into the profession, to make recommendations as to the following matters:

1. age at entry into profession
2. extent and composition of compulsory courses of instruction
3. length of service requirements prior to final examinations
4. number and frequency of examinations
5. severity of standards in successive examinations
6. the use of oral examinations
7. limitations as to the number of students employed by practising firms
8. the scale of remuneration of students

and other related subjects.

During 1952 Mr. McDonald travelled from coast to coast discussing the problem with the Provincial Institutes of C.A.'s, individual members and other interested persons. He recommended that a special sub-committee be set up to study the problem in detail and in December 1952, T. C. Kinnear, F.C.A., of Toronto was appointed vice-chairman of the committee and chairman of the special sub-committee.

Mr. McDonald's report brought together the opinions of the profession and its members as to the various elements of the problem and as to the steps to be taken to meet the requirements of the future. The committee also had available studies on the courses of instructions used by the various Provincial Institutes on the field of studies and methods of examination as well as material from the United Kingdom and the United States. After reviewing this material it was decided that reliable information should be secured as to the attitudes of students in the profession towards different aspects of the profession, particularly those relating to their training.

Professor C. R. Myers of the Department of Psychology of the University of Toronto was engaged as consultant to the committee to assist in the preparation of a questionnaire to be answered by students and in the analysis of the answers thereto. The questionnaire was in three parts. The first dealt with factual information about the personal history and working conditions of the student. The second asked for his opinion on various aspects of chartered accountancy and the third invited suggestions for improvements in recruitment and training methods.

A total of 4,002 questionnaires was mailed in the summer of 1953 to 3,539 students and 463 newly graduated chartered accountants who were students within the preceding year. The response, based on surveys of similar type, was considered eminently satisfactory — 2,440 replies were received (61% of the total number mailed).

Of the replies received and analyzed, 18% represented primary students, 36% represented intermediate students, 35% represented final students and 11% represented newly qualified C.A.'s.

Three points in connection with the questionnaire should be emphasized. First, two-thirds of the total number of replies received were contributed by Ontario (41%) and Quebec (25%) students. Secondly, a feature of the answers to the survey was the

enthusiasm and obvious sincerity with which students undertook to express voluntary comments. Thirdly, every precaution was taken to ensure anonymity of the replies and no one but specified employees of The Canadian Institute of Chartered Accountants and the consultant to the committee had access to complete individual questionnaires, and even they could not identify individuals or firms.

Briefly it may be said that the replies received from the students were analyzed and reported upon to the committee in the following manner:

Personal histories, working conditions and training conditions of respondents were analyzed both by stage of training and on a provincial basis.

Personal history was related to the education, previous occupation, age of first interest in the profession, reasons for entering the profession, the person influencing the choice of the profession, father's occupation and the student's marital status.

Working conditions were related to the size of the city, the size of the office, the hours of work, overtime, out-of-town work, vacations and salaries.

Training conditions were related to the amount of office help and guidance, organized office instruction, time off before examinations, the examination record and the time in training.

(The foregoing part of the Myers' report[1] may be considered to be based on factual information.)

The student questionnaire also included 29 questions on attitude. By means of indices, these attitudes were related to the personal history, the working conditions and the training conditions of the students by provinces and stage of training.

All of the information referred to above was taken into account by the members of the committee in formulating their recommendations.

The committee's report, containing 21 recommendations covering the broad areas of recruitment and training, was presented to the Council of the C.I.C.A. at its 1955 meeting. The report has since been reviewed in detail by the ten Provincial Institutes and the Board of Examiners-in-Chief.

Recommendations Concerning Recruitment

The committee was of the opinion that inadequacies in the methods of selecting students were mainly responsible for many of the failures in examinations. As a result, difficulty in passing examinations had become identified with the profession. This factor is believed to have a detrimental effect on recruitment out of all proportion to its incidence.

The committee believed that the answer is not to lower standards by making examinations easier (and this view was supported by the majority of students replying to the questionnaire), but to introduce the use of selection tests on a compulsory basis to discourage prospective students who are not likely to be successful in C.A. training from starting the course. Further, the committee recom-

[1] As part of the task of analyzing the replies to the questionnaires Professor Myers prepared a special 100 page report with an appendix of some 80 pages of selected excerpts of students' comments and suggestions on recruitment and training.

mended the use of a personal history form in anticipation that it would also prove helpful in differentiating between students likely to be successful in chartered accountancy training and those not likely to so succeed. The Provincial Institutes were generally in favour of such action.

The committee learned through the answers to the questionnaire that one of the most important changes required was that practitioners *show* a greater interest in the training of their students. While it appears that this interest is in fact present in most instances, it is not apparent to the student and thus he feels it lacking.

The committee was of the opinion that there were some practitioners who were paying too low salaries to students and some who were requiring students to work too long hours. While overtime work for C.A. students was reported as averaging 100 hours per year in 1953, with one-third of students working less than 50 hours overtime per year, the statistics did not reveal the extent of compensation by way of time off at slacker periods.

It was recommended that some controlling action be taken by the Provincial Institutes to regulate the hours worked by students and to establish minimum scales of salaries. In respect of the recommendation as to hours of work, two Institutes doubted they had the power to control hours of work, two Institutes disagreed with the suggestion, one did not think it a practicable recommendation, one believed that competition for staff resolves the problem, three Institutes agreed with the recommendation, and one Institute believed it had a degree of control at present.

In respect of the recommendation as to scales of minimum salaries, the same two Institutes doubted they had the power to enforce such scales, one Institute disagreed with the suggestion, the same Institute did not think it a practicable recommendation, the same Institute believed that competition for staff resolved the problem, one Institute thought it should suggest scales of salaries, one Institute thought publicity would bring about a solution, two Institutes agreed with the recommendation and one Institute had such a scale already.

The committee found that members and students alike felt that there was insufficient publicity for the profession, particularly at the high school level. The committee recommended "that a coordinated program of publicity aimed at high schools, universities and families of prospective students be inaugurated by the C.I.C.A. with the cooperation of the Provincial Institutes as conditions warrant". Also "there should be greater liaison between the various Provincial Institutes in the publication of pamphlets or brochures for use of prospective students. It is suggested that the C.I.C.A. should invite the cooperation of all Provincial Institutes to produce one basic brochure, to which could be added a separate page or so outlining the entrance requirements and special information relating to the Provincial Institute distributing it."

In order to coordinate the publicity and public relations activities of the Provincial Institutes, the committee recommended that the Canadian Institute establish a Standing Committee on Public Relations to deal with all aspects of the subject. These recommendations were generally agreed upon by the Provincial Institutes but a number of the Institutes

believed that such programs should be dealt with on a purely provincial basis.

Recommendations Concerning Training

The comittee found that some variations existed in the standards of training and experience required by the Institutes and also that the practical experience gained by the students varied from office to office. The committee recognized that there were other bodies providing accountancy training whose experience standards differ greatly from those of the Institutes of C.A.'s. It believed that the profession could gain by adjusting entrance requirements to permit entry of persons who had secured some of their formal accounting education and training outside the profession before deciding to seek professional qualification and that this might also be a step towards raising countrywide accounting standards. The committee recommended:

1. Applicants with the minimum educational requirements and with three or more years commercial accounting experience should, if they can pass a special examination, be permitted to enter at the third year level (thus – three years as a registered student).
2. University graduates should, if they can pass a special examination, be permitted to enter at the third year level (thus – three years as a registered student). In the event of one failure they would be required to take the second year course and pass the examination before being allowed to proceed.
3. University graduates who have completed courses similar to the first three years of the C.A. course or with at least three years suitable accounting experience should be permitted to enter at the fourth year level provided they pass the uniform intermediate examination (thus – two years as a registered student).
4. Exemption from the uniform intermediate examinations should not be granted to any persons.
5. Applicants, in some circumstances, should be allowed to register before having obtained full high school standing on the understanding that, before writing the primary examination, they would be required to have disposed of their deficiencies in high school standing.

While the majority of Provincial Institutes agreed with numbers 1, 2, 4 and 5 of these recommendations, some had strong objections to one or more, and present legislation or arrangements with universities would make it impossible for some Institutes to put such recommendations into effect. The Institutes generally preferred that each application for special consideration be considered on its merits rather than under a broad revision of the entrance requirements. Recommendations 1 and 2 would require the Institutes to organize another uniform examination in addition to the present intermediate and final examinations. The majority of the Institutes were not prepared to adjust entrance requirements along the lines set out in recommendation 3 because they believed that a minimum of three years experience in the office of a practising chartered accountant should be required of any person seeking qualification as a chartered accountant. However, the Quebec and Saskatchewan Institutes agreed in principle with this recommendation.

The main criticisms by students of the courses of instruction were:

1. The method of correcting correspondence lessons gave little guidance to students as to the nature of their mistakes.
2. Some of the lessons should be revised to bring them up to date. (*Note*: as at 1953 only the first year of the revised course had been introduced. Starting in 1956 the complete revision will have been wholly introduced.)
3. Return of corrected assignments is unduly delayed.
4. There should be more emphasis on taxes, various aspects of business administration and English composition.
5. There should be more and better office and classroom instruction provided.

The committee was of the opinion that deficiencies such as 1 above could, and perhaps should, have been remedied by students themselves seeking help from their principals.

The committee believed that supervised discussion sessions should be organized. It also recommended that Provincial Institutes establish Education and Training Boards to maintain continuous study of training methods.

In looking to the future, the committee was of the opinion that eventually the theoretical training will be secured through educational institutions such as universities and that successful graduates will enter the profession as trainees to secure their practical experience, writing their C.A. examinations upon completion thereof.

The committee received numerous suggestions for the addition of special subject matter to the courses of study. Most of these were related to the needs of the C.A. in business. The committee believed that the present courses of instruction could not be expanded appreciably and, while not having made an exhaustive study of the training needs of the student planning a career outside of the profession, was of the opinion that such subjects would be better dealt with through post-graduate courses.

The committee received many criticisms of the examinations but was of the opinion that written examinations were the only practical measurement of qualification and that, in fact, the examinations are as fair as any examinations can be. It recommended that the present three stage system of examinations (primary, intermediate and final) should be replaced by a five stage system (an examination at the end of each year of the course). Also recommended was that the time and content of each examination paper should be decreased but that the number of papers should be increased.

Since the past experience of students indicates that those C.A. students who pass on first attempt at any stage do better at later stages than those who succeed in recovering after one or more failures, the committee recommended that students be limited to two attempts at the present primary and two attempts at the present intermediate stages. Also recommended was that students who have failed an examination be required to repeat the last completed year of the course of study before again sitting for the examination. The committee recommended that students be required to write their examinations on schedule rather than under the present scheme whereby the student

is not required to write an examination unless and until he feels he is ready.

The Provincial Institutes generally agreed that it was advisable to introduce a five stage system of examinations but the problems of arranging for the preparation and grading of two additional sets of papers each year presented an immediate practical difficulty. In Manitoba and Quebec such a plan was in operation since these Institutes had annual examinations as a part of their courses of instruction.

A number of the Institutes agreed that it would be desirable to decrease the time and content of the examination papers and to increase the number of papers. It was thought that such a move might be accomplished more readily with the auditing papers than with the accounting papers.

Most Institutes already restricted the number of attempts at the primary examination to two and at the intermediate to three and are of the opinion that such restrictions are adequate for the present. The Institutes were not in favour of requiring students to repeat the course if unsuccessful in an examination.

The committee considered the possibility of students submitting evidence of proficiency in specified field operations appropriate to each stage of training in order to measure their practical ability on the job. It was suggested that standardized work sample tests, supervised and appraised by the student's own office, would contribute to the actual as well as the apparent integration between theory and practice. The committee recommended that "an employer be required to submit a written report on each student once a year stating that the student has satisfactorily completed certain types of field work. It is recognized that different standards would be applied by different employers in appraising students, but such a report would nevertheless serve to emphasize to the practitioner his obligation to provide practical training for the student. In addition to being signed by the practitioner the report should be signed by the student and its receipt, in a form satisfactory to the Examination Committee, would be required before a student would be permitted to sit for an examination at his stage of training." The Institutes were of the opinion that such a report would not be practical.

Replies to Questionnaire

It is not possible in this condensation of the report of the Committee on Recruitment and Training to set out in any detail the replies to the questionnaire sent to students and recently qualified C.A.'s in 1953. However, the following from the summary and conclusions of Professor C. R. Myers' report to the committee may give some indication of the nature of the information and opinions submitted by the students in completing the questionnaires and how such data were analyzed.

Personal History

The educational history of C.A. students replying to the questionnaire shows that elementary school progress was, for most of them, either normal (60%) or accelerated (31%), but that the remainder (9%) were significantly late in passing their entrance examinations. Most C.A. students had the usual four or five years of high school training, but 20%

had less than this amount. Four out of ten attended university. Of these four, two earned a Commerce degree, one earned an Arts degree, and one failed to earn any degree at all.

After leaving school, 40% of C.A. students worked at some other occupation before entering C.A. training. In nine out of ten cases, their first interest in it did not occur until they were in their late teens or early twenties. Their chief motives for entering C.A. training were business experience, professional prestige, personal suitability and economic reward. Their decision to do so was mainly influenced by members of their immediate family, chartered accountants and teachers. In a majority of cases, the fathers of C.A. students were businessmen. At the time of the survey, nearly 40% of all C.A. students in Canada were married, and of these, nearly half had children.

In estimating the chances of success in C.A. training, the following personal history characteristics are favourable: a period of employment (other than C.A.) after leaving school; first interest in C.A. after 20; motivation chiefly professional prestige; influenced mainly by immediate family; father a business man.

The most promising recruits for C.A. training are likely to be found, not in school, but in two other areas: (a) high school graduates who have been out working for some time, and (b) university seniors, in particular those completing Commerce courses. The optimum age group is the early twenties. The motive to emphasize is professional prestige rather than economic gain. The best recruiting agents are parents and wives. The part of the population to reach and interest is the urban business population.

Working Conditions

The "typical" C.A. student in Canada served his apprenticeship in a C.A. office located in one of Canada's six largest cities. He worked in an office where there were five or six C.A.'s and about 10 other C.A. students. A greater proportion of senior students than junior students worked in larger offices and in the larger cities.

During the busy season each year, a student was required to work about 42 hours per week. At other times, his work week was about 35 hours. His overtime work amounted to about 100 hours per year. He was on out-of-town assignments for a total of about one month per year. He was allowed two weeks' vacation with pay.

Training Conditions

Training conditions in C.A. offices also showed wide variations. However, the help and guidance given to students in their offices was considered inadequate by more than one-third of those reporting. Less than one-third of the students reported anything in the way of organized efforts to supplement instruction by periodic office meetings for this purpose. Where such efforts were made, they were considered helpful by about half of the students. The provision of office training materials and the holding of regional meetings were reported by one-third of the group, and these were considered helpful by 60% of the students to whom they were available.

There was no standard office practice in regard to allowing time off before examinations except that, if there was any allowance for first attempt, this was reduced or eliminated for students who failed and had to try again later.

One-quarter of all C.A. students in training in Canada were "repeaters". They had already failed the examinations for their stage of training at least once. The chances of failure increased rather than decreased as the student reached later stages of training. Thus, of successful students who qualified in 1952, 12% failed their primary, 25% failed their intermediate, and nearly 50% failed their final examinations before qualifying.

The actual time-cost to qualify as a C.A. was in excess of the time that C.A. training was supposed to take. At least one-third of all C.A. students had already taken more than the number of years supposed to be necessary to reach their present stage of training.

Morale

In certain important respects, C.A. students in Canada exhibited a very high level of morale. They were enthusiastic about the kind of work involved in chartered accountancy, and had a high regard for chartered accountancy as a career. Except for the features specified below, they were generally favourable to the system of C.A. training and the office conditions under which they worked.

On the other hand, they were somewhat dissatisfied with the conditions under which they had to do their studying, and they very much doubted whether the examinations they had to pass represented a valid measure of actual C.A. ability. The two features of C.A. training most frequently criticized were: (1) the instructional methods used in the course, and (2) the level of student salaries.

Student morale varied from province to province. The critical factors in producing these differences in student morale appeared to be provincial differences in the organization of the course and in the instructional methods used. It was significant that provincial differences in the salaries paid to students seemed to bear no relationship to these differences in student morale.

Those who entered C.A. training after obtaining a university degree in Commerce, (although they actually did better and were therefore better prospects for training) were much more unfavourable in their attitudes toward C.A. training than were those who entered with an Arts degree or without any university training at all. Those who chose C.A. training chiefly because of a "power" motive (high income, prestige, influence) were also later more dissatisfied than were those who chose it because of lack of money or because they thought themselves specially suited for accountancy. Likewise, students who were "guided" into C.A. training by a school counsellor were more dissatisfied than those who were influenced mainly by a C.A., presumably because the latter was more realistic in his "briefing".

There was little evident difference in morale between students working in large C.A. offices and those working in small C.A. offices. There was much less relationship between salary and morale than might be supposed.

The relationship between training conditions and morale was close and direct. C.A. students who had been relatively successful in examinations and who had made reasonable progress in training showed much more favourable attitudes toward all aspects of C.A. work and C.A. training.

Student Suggestions

C.A. students suggested that the 1953 student salary scale would have to be raised and made more uniform if C.A. training was to compete with alternative opportunities available to young people. They proposed that more and better publicity should be obtained for the profession in order to enhance its attractiveness in the public mind. They suggested that the profession take steps to reduce the current failure rates in C.A. training by more careful initial selection, by earlier elimination of unsuitable students, and by improved training.

C.A. students urged the necessity of providing some elements of university-type training and classroom instruction by professionally skilled teachers. They were emphatic in recommending that some method be found to induce C.A. firms to provide real apprenticeship training in the offices in which they work. In addition to these major recommendations, C.A. students offered a large number of specific and potentially valuable suggestions concerning the revision and improvement of correspondence lessons, assignment marking, course content, textbooks and examination system.

The extent and nature of C.A. student response to the questionnaire indicated clearly that it was welcomed by them. They regarded the survey as evidence that the profession was genuinely interested in finding out more about its own training system. They naturally hoped that the results of the survey would lead to some changes and improvements in that system. They suggested that C.A. students should be informed about the findings of the survey. They considered that they shared with qualified members of the profession a genuine desire to see that C.A. training was as thorough and effective as circumstances would permit. They thought that more understanding on their part would serve this end.

Conclusion

The committee's report and the other information developed for their study of recruitment and training will be under continuous review by the Institutes of Chartered Accountants. While it may appear that changes and adjustments are slow in appearing, it must be emphasized that the profession will continue to consider the problem of recruitment and training most seriously with the view of putting into effect any changes which are in the interests of the profession and the community at large.

A Review of Electronic Data Processing Equipment

LEO J. LACEY

A PREVIOUS article in this series "A Review of I. D. P. Equipment" described a variety of machines which are activated by or which will produce punched-paper tape. In many cases this type of equipment will be used for the recording and transmittal of original data to a central processing installation which may be conventional punched-card equipment or an electronic data processor. This article considers the principal characteristics of the various types of electronic equipment which are available in Canada to act as the hub of such an integrated data-processing system.

The development of electronic computers since the Second World War and more particularly over the last five years has proceeded at an extremely rapid rate. The first machines built during and immediately following the war were designed primarily for scientific and technical calculations. Even these early machines could perform arithmetical and logical operations at a speed which captured the popular imagination and articles appeared in the press describing the extraordinary ability of the so-called "electronic brains". Problems which required a long series of calculations to be performed on relatively few input quantities, with a correspondingly small number of results, were handled successfully on these machines. They were, however, so restricted in their facilities for input and output that they were practically useless for handling the masses of data typical of most business problems. About six years ago, Remington Rand produced the first machine which had a practical application to business data-processing. This machine, the Univac I, overcame the input-output problem by using magnetic tapes as an intermediate storage device between the main computer and the auxiliary equipment. Data to be entered into the computer are written on magnetic tapes by cheap key-driven machines, working in parallel. Magnetic tapes can be read into the machine, various computations, summarizations and other operations performed, and the results written out onto other magnetic tapes at very high speeds. The output tapes can be removed from the computer and the results printed on independent electric typewriters. The use of magnetic tapes in this manner has now become general for machines of all types, but

electric typewriters, as printing media, have now been largely superseded by line-printers which operate from magnetic tape at speeds of up to 1,000 lines per minute.

The Univac, which a few years ago was unique, is now one of a variety of electronic business systems brought to the market by competing manufacturers. Almost all suppliers of business equipment are now offering one or more electronic machines. Many writers have chosen to classify computer systems as small, medium or large according to their capacity and price. At the present time, when computer systems are available at almost any price from $4,000 per month to $50,000 and upwards, any such classification is simply a question of setting arbitrary dividing levels. Even the price for a given model of machine can vary greatly according to the number of auxiliary pieces of equipment which are incorporated into the system. For example, an IBM 650 with punched-card input and output rents for $3,700 per month, while on the other hand a 650 system equipped with a full complement of magnetic tapes, core storage, random access-storage, and direct-printer output can cost more than $20,000 per month.

In comparing the capabilities of various types of electronic equipment close attention must always be paid to the price. Technical developments have now advanced to the point where, within reason, anything is possible, provided the user can afford to pay for it. Although it has been claimed at times that cheaper units can provide a system which will perform as well as the large machines and sell at one-half or one-quarter of the price, such contentions have never stood up under searching examination. In certain situations particular features of one system will give it an edge over the competition, but it is generally true to say that the highly competitive state of the market makes the price-tag a reasonable measure of the quality and capacity of the machine.

Features of Electronic Computer Systems

Before describing the principal characteristics of the more popular computer systems, it is desirable to consider briefly the features of the equipment which might be used as the basis of a comparative analysis. The heart of an electronic computer is the main memory wherein are stored the programs which the machine is following and the data upon which it is currently working. The important features are the size, as measured by the number of characters, words or instructions which the memory will hold, and the speed at which one word may be located within the memory. Capacities vary from 1,000 to 120,000 alphabetic characters, and access-times from a few microseconds to several milliseconds.

In support of the main memory there will be some form of auxiliary storage which holds the mass file-data which is an essential part of most business problems. This storage normally consists of reels of magnetic tape. The efficiency of the magnetic tapes has a considerable influence upon the overall operation of the computer system. Reading and writing speeds which vary from two to 60,000 characters per second are of prime importance. The organization of data on the tape which may be in either fixed or variable length blocks, the capacity of a single reel, the number of tapes which may be attached

at one time to the central computer, and the ability of the machine to read tape moving in either direction are other points for consideration.

Some systems provide storage buffers which enable the reading and writing of tape and computing within the main memory to proceed simultaneously. Other systems permit a magnetic tape to be searched for a particular block of information while the computer proceeds with some other part of the processing. All systems provide for magnetic tape to be checked as it is read into the main memory but whereas some automatically stop upon detecting an error, others are equipped to reverse the tape automatically and read it again in an attempt to get an error-free reading without interrupting the processing. These features all have an effect upon the efficiency of the tape-system in a practical operation.

The third feature to consider is the arithmetic and logical ability of the central processing unit. It should not be supposed that the simplicity of most business calculations makes the internal operating speed of minor importance. Most business applications require a large number of instructions for making logical decisions which classify the data, select the appropriate parts of the program and test for irregular cases. Although in some cases the overall operating speed is governed by the time taken to read magnetic tape or other input data, in many applications the computer itself is a limiting factor in the overall operating speed. Apart from the operating speed which may be from 100 or 200 up to 10,000 operations per second, machines differ materially in the flexibility of the instructions provided for performing logical operations. The type of instructions provided affects the ease of programming and the number of instructions required to perform a given operation.

Part of the computer system, though not always part of the central computer, is the auxiliary devices required for data input and output. In large, expensive machines the principal form of input is magnetic tape which has been prepared from other forms of recording media independently of the main computer. The availability and operating characteristics of conversion equipment which will read punched-cards or punched-paper-tape and write magnetic tapes must be investigated. At the other end of the process the types of printer available for printing large-volume outputs from magnetic tapes is equally important. Lower-priced equipment may have card readers or paper tape readers attached directly to the central computer. Line-printers or card-punches are often attached directly to this class of machine for output. When direct input or output is used it is most important that the operation be buffered so that input-output and processing may proceed simultaneously.

Of paramount importance to the operation of any computer are the checking features which are provided throughout the system. Arithmetic accuracy is generally not a problem since the arithmetic unit is usually one of the most reliable parts of the machine and programming checks can generally be applied to this part of the operation without undue difficulty or serious loss in operating speed. Most careful attention must, however, be paid to checks which are provided on the transfer of information from one part of the system to another. For

example, checks on the reading and writing of magnetic tape, on the reading or punching of cards, and on the output to printers are all of great importance.

Two computer systems, the RCA Bizmac and the Underwood Elecom 125 can contain a separate unit for sorting and other file-processing operations on magnetic tape. This unit, which is cheaper than the main computer, relieves the central unit of simple tape-handling operations which do not make use of the computers' arithmetical and logical abilities. The existence of these magnetic-tape processing units increases the power of the systems in which they operate and cannot be overlooked in making an evaluation.

Current Systems on the Canadian Market

Having thus considered the general features of computers, the principal characteristics of seven or eight of the electronic systems currently offered on the Canadian market may now be briefly outlined. The machines selected are those which have been or are expected to be produced in quantity by well-known manufacturers in the business equipment field. Certain machines are excluded because they are too small to be regarded as the centre of an integrated system. A notable omission from the large-scale class is the Datamatic 1,000 of the Datamatic Corporation, recently purchased by Minneapolis-Honeywell because detailed information is not yet available. However, since advance publicity indicates that this machine may have a tape-reading speed of 60,000 characters per second, in addition to other features, it may prove to be worthy of consideration by potential users of large-scale equipment.

Univac I and II

The Univac I machine referred to earlier is still available as a production-line model. It will, however, be replaced in 1957 by the Univac II which is an improved version having approximately double the speed and capacity. The new model has a magnetic-core memory containing 24,000 characters which can be expanded at extra cost up to 120,000 characters. The magnetic-tape reading and writing speed is high (20,000 characters per second) but a fixed word and fixed block organization is employed which is a factor in its efficiency. A complete line of auxiliary input-output equipment is available including one or two machines which are unique to this manufacturer. Magnetic tapes for the Univac may be prepared directly from key-driven machines similar to a typewriter. On all other equipment, key-driven equipment produces cards or paper-tape which is subsequently converted to magnetic tape. The relative merits of these alternative systems can be debated at some length.

Also unique to the Univac is an electric typewriter operated by magnetic tape. Other systems employ line-printers driven by magnetic tape which, although much faster, are also considerably more expensive. A line-printer operating at 600 lines per minute is also available with the Univac. Remington Rand has recently anounced the development of the MTM Trans-recorder which is a device for transmitting directly from magnetic tape over wire circuits and recording directly onto magnetic tapes at the receiving end. Also in development is a card printing-punch which produces 150 cards per minute from magnetic tape. In addition to

punching the cards the machine will print on both sides at 900 lines per minute.

IBM 705

The IBM machine in the large-scale field is its model 705. A notable feature of the machine is the building-block principle employed in its construction and the interchangeability of the functions of the various units. Thus, for example, a card-reader may be attached to the central computer for direct input from punched-cards or it may be attached to a magnetic-tape unit whereupon the two units together form a card-to-tape converter. In the same way, printers and card-punches may be used for either on- or off-line operation. Information on magnetic tapes is organized in variable fields and variable blocks. The tape-reading speed is 15,000 characters per second and up to 100 units may be attached to the central computer. The main memory of the machine is magnetic cores with a capacity of 20,000 characters as the standard and a maximum capacity of up to 40,000. Magnetic drums are available as additional memory space. The standard machine does not have buffer units for reading and writing magnetic tapes, although the read-write operations can take place simultaneously. Special buffer units called "tape record co-ordinators" are available at extra cost.

RCA Bizmac

The third large-scale machine to be considered is the RCA Bizmac. This machine employs a small core-memory of 4,092 characters supported by a magnetic drum from which blocks of instructions or data are transferred to the main memory. Magnetic-tape reading and writing speed is rather slow for large-scale equipment (10,000 characters per second), but the organization of the data in variable word and variable blocks makes maximum use of the tape storage. The system may contain a separate tape-sorter for sorting and other file-processing operations on magnetic tape. A separate unit is also available for searching magnetic tapes to extract and print any required piece of information. In addition to the normal type of electro-mechanical line-printer, there is available a printer of unique design which operates from magnetic tape to 35-millimetre film and then to hard copy. This produces at a rate of 6 inches of paper per second.

These three large systems stand apart from the other machines to be mentioned both as regards capacity and price. They cost upwards of $30,000 per month to rent or $1,500,000 for outright purchase. All three handle alphabetic and numeric information with equal facility which distinguishes them, in general, from the cheaper models. The automatic checking features in these machines are very good.

Systems of the Magnetic-Drum Class

All large suppliers of business equipment now offer complete data-processing systems of the intermediate magnetic-drum class. These include the Datatron now owned by Burroughs, the Elecom 125 and file processor supplied by Underwood, the IBM 650, and the Remington Rand File Computer. A recent arrival on the Canadian market is the Elliott 405, an English-built computer, which is of a similar class. The rental for average systems containing the computer, tape units,

printers and auxiliary equipment is from $10,000 to $20,000 per month.

The principal distinguishing features of the Datatron system are the Cardatron and the Data-bin. The Cardatron is a buffer storage device permitting parallel operations of up to seven input-output devices without holding up the computer. For example, three card-inputs, two card-punches, and two 407-printers can be controlled by the computer. Up to 10 magnetic-tape units may be attached. The Data-bin is a large capacity random-access storage unit. The principal objection to magnetic tape as a storage medium is that information is recorded in a strictly serial fashion. For example, to reach a record entered at the far end of the tape it is necessary to pass the whole reel of tape through the tape-unit. Up to 10 Data-bins can be connected to a Datatron, each bin having capacity for 100,000 individually addressable blocks, each of 200 digits. Pure random-access is slow, the average access-time being approximately 16 seconds. In most applications, however, it will be found possible to organize the data according to some pattern which will shorten the access-time considerably.

The Elecom 125 machine is the only medium-class system offering a separate piece of equipment for sorting and other file-maintenance operations on magnetic tape. The file-processor performs on magnetic-tape records the same type of function as are performed by a collator and a sorter on punched-cards. Any number of magnetic-tape units may be attached to the computer. The basic read-write speed on the computer and file processor is 6,000 characters per second. A tape buffer unit is available as an optional feature permitting input and output of tape to proceed in parallel with computation. Punched-card input and output are possible and the computer can operate directly to an IBM 407-printer. Underwood has an off-line printer operating from magnetic tape at 900 lines per minute in development for use with the Elecom system.

In its original form, the IBM 650 was a simple magnetic-drum machine having only punched-card input and output facilities. This basic unit can now be expanded by the addition of magnetic tapes and other auxiliary units into a complete data-processing system. The magnetic tapes are the same as those used on the 705 and are read and written at the same speed of 15,000 characters per second. An auxiliary storage unit is used as a buffer for the magnetic tapes. This unit provides 60 words of magnetic-core storage which can be used as fast access-memory when not required as a tape-buffer. A combination of three input-output devices may be attached which may be card-readers and punches or on-line printers. The printing unit is a converted 407-tabulator, and when used in this way the card feed on the 407 may be used for additional input. The most recently announced additions to the system are the Ramac and the model 838 Inquiry Stations which are scheduled for delivery in 1957. The Ramac is a random-access storage device holding 10,000 records of 600 digits each. Up to four such units may be attached to one system and the average access-time is of the order of half-a-second. The inquiry stations consist of an electric typewriter and a control unit which enable the status of any record in the system to be determined with only momentary interruption of processing.

The Remington Rand File Computer is available in three models and varying sizes. The distinction between models is principally in the method of control which may be either (a) by plugboard wiring, (b) by internally-stored program, or (c) by both methods. The principal features of the machine are the very large drum-capacities available and the large number of input-output units which may be attached. Up to ten drums, each containing 180,000 digits, may be included in one system. Up to 31 input-output devices, such as punched-cards, magnetic tapes, paper-tapes, line-printers and keyboards, may be operated in parallel. The units attached may be scanned in sequence to determine which one is ready for processing or a fixed sequence may be assigned for the operation of the units. The magnetic-tape units are expected to be similar to those used on the Univac I and will operate at 10,000 characters per second. Off-line printers for operating from magnetic tapes are available with this equipment.

Both the File Computer and the 650 can write magnetic tape in the form used by the Univac and the 705, respectively. It will thus be possible to use auxiliary equipment such as card-to-tape converters or off-line printers primarily designed for the larger systems with the smaller machines.

A recently announced machine from IBM which will be of interest to a number of smaller businesses is the Ramac 305, a machine containing a random-access storage of 50,000 records of 100-characters each, a card-reader, a card-punch, a computing unit, a typewriter, and a special printing unit. The system is supplied as a unit at a rental of $3,600 per month.

The speed with which electronic data-processing equipment for business use has been developed during the past five years testifies to the importance with which manufacturers regard the market potential. There seems litle reason to doubt that the next five years will bring still further rapid technological advances as the growing number of users gains first hand experience in the remarkable capacities of these new wonder tools.

Grain Exporters and Shippers Accounts

WILLIAM AITKEN

THE PREDOMINANT influence in the grain business during recent years has been the intervention of the federal government in controlling the marketing of wheat, oats and barley and related farm products, with vegetable oil content. State compulsory marketing became necessary to cope with the depressed conditions in Western Canada when external influences caused a virtual breakdown in the economic price structure. Foreign markets were greatly restricted and the normal flow of these grains to market was vitally affected. Drastic remedies had to be applied and where formerly open markets enabled shippers and exporters to contract for and handle the movement of grain into consumptive channels in the domestic and overseas markets, the lack of demand for these products necessitated legislation to implement compulsory marketing.

The emergency arising from World War II emphasized the need for such restrictions on the activities of entrepreneurs, and the machinery required to give effect to the requirements of the Canadian and Allied governments was expanded to deal with this problem. In the earlier stages, with fluctuating market levels, the voluntary basis introduced under The Canadian Wheat Board Act, insofar as its pooling operations were concerned, was to some extent an experiment. However, under the chaotic conditions resulting from the war, this experiment crystallized into a regulatory body that ultimately rendered a great contribution to the war effort. Subsequently with unrest prevailing in so many countries, this situation had been aggravated, and The Canadian Wheat Board had of necessity to continue to function.

When extraneous influences on the price structure approach the normal, a logical solution to the Canadian grain problem will be to revert to the open market basis with possibly some degree of flexible price control and the elimination of restrictions on the primary futures markets which are essential to competitive marketing in the sale and distribution of grain from the prairie provinces. The merits or demerits of either form of marketing do not fall within the purview of this discussion; suffice it to say that certain of the aspects of both methods have to be dealt with in determining precisely the impact under the agreements entered into with The Canadian Wheat

Board to regulate export sales of western wheat produced in the designated area, and accordingly it has become a closely integrated unit with the grain trade.

The conditions under such agreements vary from year to year in promulgating the regulations. However, the procedures are to a great extent identical, with the exception that where title to the grain is vested in the Board, the exporters and shippers operate under agency agreements and render to the Board account sales in conformity with importers' quotas and controls and at the prevailing prices announced by the Board, or on the deferred prices applicable under the agreements to bookings on this basis.

In order to obtain an understanding of the operations of grain exporters and shippers, it is essential that one should trace the movement of the physical grain. The present discussion is limited to the more important factors of this particular phase of the grain business, but it includes certain related problems encountered in quasi-governmental or pooling projects.

Hedging in the Futures Market

Cash and futures contracts are closely linked together in price through the right of delivery. In "futures" contracts, with the exception under current regulations of the futures in wheat operations in the Winnipeg market, transactions are entered into for the purchase and/or sale of grain during a specified deferred month but are not complete until fulfilled during such month and are governed by the rules and regulations of the respective grain exchanges. In practice very few contracts are ultimately so fulfilled, the great majority being offset at some point prior to or during the month of delivery.

While the cash and futures markets are held in general alignment through this right to convert, certain elements may be expected regularly to cause some deviation in the relation of the two markets. The amount of seasonal movement varies widely, reflecting changes in deliverable as well as in total supplies, in receipts and shipments, in the condition of supplies, available storage space, shipping conditions and many other current market factors. These are the factors with which the hedger is most concerned.

By hedging cash commitments through counter-balancing futures transactions, grain concerns are in a position to minimize their risk incident to major movements in price. The practice of hedging is based upon the assumption that prices in the cash grain market will parallel those in the futures market. Of outstanding importance as a cause of uncertain variations in the cash-futures relationship are the current supplies of grain at principal market centres. After allowance is made for seasonal trend in cash prices the two markets conform fairly closely in their broad price movements, although for particular years and under the influence of special factors prices deviate considerably. In practice these deviations result in either decreasing or increasing the profit anticipated by a grain exporter, dependent upon the nature of his market position and the direction of price variation; but it is also true in practice that where hedging is consistently used on a fairly wide scale, profits or losses occasioned by these minor deviations to some extent offset each other. Success in

hedging thus largely depends upon the maintenance of a normal and dependable relationship between cash and future prices.

Because trade in futures normally assumes much larger proportions than that in cash grain, special effort is made by those trading in futures to obtain every variety of market information. For this purpose elaborate wire systems, trading facilities, and news gathering agencies are employed which are not duplicated by the cash markets. For this reason, the futures markets are the first to receive and reflect current trade information. The cash market depends on the futures market as a basis for bids and in the placing of hedges. Thus, the sequence of change is from factors of market importance through futures prices to cash prices. The trade in futures, however, does not determine prices in the cash market, although the same general information accounts for both the level of cash prices and of futures. In reaching the cash market, however, it is subject to the interpretation of trading conditions prevailing upon the futures market.

It is evident that a double responsibility rests upon the futures market in its interpretation of crop and market conditions. If these are fairly and accurately interpreted, both futures and cash prices in turn will reflect prevailing trade conditions. But if for any reason the futures market poorly and inaccurately interprets basic conditions, the result will be an artificial and distorted level in cash as well as in futures prices.

The futures market, in the normal course of events, serves as the gateway to the entire price structure. Upon it are focused the important forces of supply and demand. To properly interpret these, every effort should be made to maintain free interplay between the futures market and the cash market. It is only in the absence of extraneous influences that future trading can be justified from an economic standpoint and can serve fully the varied interests of the grain trade.

Market Position

To maintain effective control over current operations each department in the export grain organization must prepare daily summarized reports covering handlings of grain received or purchased; sales and sales commitments and the basis (flat or futures exchanged); grain delivered; futures exchanged; futures open to be exchanged; futures sold, and similar data essential to the preparation of the statement of market position. Particular attention must be given to cash grain contracts on which futures have been exchanged but grain not delivered and vice versa, and to those on which the price is to be determined basis exchange of future at time of delivery. There is thus available data for the preparation of statistical information required, and the control necessary to prove its accuracy.

Valuation of Cash Grain Stocks

Inventories of cash grain are taken off by grade giving full particulars as to date of terminal warehouse receipts, date stored, price and valuation. The quantities agree with the statement of market position. The net stocks of cash grain, after taking into account open commitments for cash grain purchases, are valued by grade after deduction of stocks required to fill open sales contracts.

The bushel quantities of net cash grain stocks, open cash grain sales contracts and futures contracts combined check with the open market position previously outlined.

Important factors in considering the valuation to be placed upon inventories of cash grain available for sale are the proximity of grain to the market at which disposition will ultimately take place and the period required to effect sales. As the grain is moved into strategic positions to be made available to fill commitments, transportation costs, usually on the basis of current rates, to Bay, Eastern or Atlantic seaboard points must be added to the spot or in-store price at Lakehead. Generally, the spot close on the market is taken as the basis of valuation but where stocks are carried in any volume the basis may be the nearby future. This latter treatment is preferable where heavy cash grain stocks are carried, the disposition of which may possibly be spread over a period of several months. No advantage can accrue from valuing such stocks on the basis of the spot close where a premium obtains for cash grain as against the future in the nearby months.

When abnormal circumstances alter the situation to any considerable extent, however, the valuation of inventories may not prove quite so simple. Extreme care will be necessary when any major variation in the general economic situation can be foreseen. This feature, in practices relating to grain accounting, is obviously influenced by factors arising out of the tariff and fiscal policies of importing countries, and other extraneous efforts to regulate the flow of grain into consumptive channels.

In quoting the October future, for example, it is necessary to consider such elements as available supplies, prospective production, hedging pressure, shipping and climatic conditions, the international monetary situation, etc. It is a difficult problem to determine what are major swings and mere fluctuations in market trends, yet it is desirable that this factor, entering into inventory valuation, should not be overlooked.

Valuation of Open Sales Contracts

Open cash grain contracts are tabulated by grade, showing contract number, date, buyer, grade, quantity, price basis and position with carrying charges computed to date of completion. Many factors have to be considered in determining the valuation to be placed upon open sales contracts. Even at its best the export grain business is of an extremely hazardous nature and calls for highly organized machinery in its operation. Insofar as shipments are concerned, contracts for space on both lake and ocean steamers must be considered in relation to the delivered price of grain. Adequate protection must be afforded against fluctuations in foreign currencies as sales contracts are effected. Provision for loss should be given effect to in the accounts even although this may actually be incurred subsequent to the cut-off date. Furthermore, adequate provision should be made in the preparation of the accounts for all outstanding charges against open contracts.

Loading Lake Vessels at Fort William–Port Arthur

Loading may be divided into two sections, namely, "Intention to Load", and "Clearance". In the former case, the exporter from the shipping com-

pany, once notified that the vessel is ready to load, advises the Lake Shippers Clearance Association regarding particulars of loading. A form for this purpose includes:

(1) Intended date of loading
(2) Grade
(3) Quantity
(4) Lake bills of lading data
  (a) Order party
  (b) Notify party
  (c) Care party
  (d) Destination
  (e) Bill of lading
  (f) Other instructions.

Grain for export to the United Kingdom was at one time generally sold basis "Loads" which constitute a thousand quarters of grain, although currently on the basis of long tons. Therefore the bill of lading splits (bill of lading split as to quantities) for wheat and coarse grains sold for export are generally made out for the products, with their respective quantities, as listed. Loadings covering grain not shipped for direct export are generally split to correspond with the sale quantities.

Once the grain leaves the elevator spouts, full responsibility for the cargo rests upon the shipper as the vessel contract, unlike the terminal elevator storage tariff, does not automatically protect the shipper against marine disaster. The insurance company furnishes an insurance binder for temporary coverage upon presentation of a "Provisional Declaration" containing the following information:

(1) Vessel
(2) Intended date of loading
(3) Destination
(4) Grain
(5) Quantity
(6) Approximate value.

The exporter is advised regarding clearance of loading figures, date of the bills of lading and stowage, etc., the "C.I.F." buyers of grain on board are notified of the vessel clearance, the shipper's agents at destination are advised of any unsold quantities, and the branch forwarding agent or the buyer is also notified. The insurance underwriters, upon notification of the exact loading and value, issue regular insurance certificates replacing the provisional binder with the exception of cases where a floater policy is in effect.

As the grain is weighed into the designated terminal, frequently differences between the lading weight and inward weight are apparent. Claims are lodged against the insurance underwriters for shortages which may result from discrepancies in scales or shrinkage or loss during elevation, but the shipper is required to purchase any overage from the underwriter unless of course the exporter carries his own outturn insurance.

Further to playing a very great part in grain transportation, grain vessels are also chartered for "Winter Storage" when loaded just prior to the close of navigation, and when booked for this purpose, dock alongside the terminal elevators so that they may be unloaded at any time. If unloading is to be negotiated by the vessel owners, shippers receive free storage to a specific date, but if unloading is to be done by the shippers, free storage rates are allowed and regular storage rates apply provided the cargo is unloaded before a specified date. For this storage privilege the shipper pays an increased rate but, generally speaking, a saving is effected on grain stored in this manner.

Movement to Lakehead

A shipper moving grain to Montreal engages lake freight, arranges for outturn and marine insurance and places the loading order with the Lake Shippers Clearance Association. Lake freight is payable on bill of lading quantity.

All grain loading at the Lakehead, either to cars or steamers, is subject to inspection by an authorized inspector employed by the Board of Grain Commissioners. After loading, the Lake Shippers Clearance Association issues the lake bills of lading in accordance with the shippers' instructions but in no case in larger denominations than 10,000 bushels in order to facilitate handling of documents in effecting sales and to afford some protection against alteration on quantities. Inspection certificates, issued by the Board of Grain Commissioners, are so divided as to match the quantities shown on the bills of lading. One weight certificate is issued to cover the entire quantity loaded. Rail bills of lading are issued for any car-lot shipments.

Smaller lake steamers are usually engaged to proceed directly to Montreal via the present canal system. Larger steamers trans-ship their cargoes at Buffalo, Port Colborne, Prescott or Kingston. After completion of unloading at trans-shipping point, consignees are advised by the elevator as to the outturn quantity, date steamer discharged and quantity damaged, if any.

The upper lake carrier makes arrangements for canal steamers to move its cargo forward to Montreal. As each canal boat is loaded, the consignees receive notification and non-negotiable bill of lading from the elevator company. On arrival at Montreal canal steamers are given unloading priority only when the grain is required for immediate shipment, otherwise they await their turn for unloading.

Vessel agents at seaboard points such as Montreal notify the National Harbours Board or independent owners to receive the grain through the issuance of a receiving order, which states quantity, grade and kind of grain, stowage, "notify party" (person to whom notification must be sent covering shipment) and name of steamer carrying grain.

Tallymen are placed in all the Eastern elevators by the outturn insurers to prevent possible errors in weighing. When final outturns are known, claims for shortages and damaged grain are lodged against the insurance companies.

The lake and rail method of moving grain to Montreal is more rapid and more costly than the all-water route. Shipments from the Lakehead are discharged at the elevators located at Bay ports and the grain remains there until ordered forward by the owner. "Shortage" (excess of loading over outturn quantity) in excess of 1/8 of 1% of the quantity billed forward from the Bay Port elevator is payable by the rail carrier. Due to the relatively high freight rate, all rail shipments are made to Montreal only when absolutely necessary to complete delivery against specific contracts.

Handling Bills of Lading at Montreal, Sorel, Quebec or Three Rivers

All lake grain bills of lading must be issued in quantities not exceeding 10,000 bushels, and the actual quantity of grain represented by the bill of lading is marked with a protecto-

graph writer. All endorsements must appear in proper sequence on the reverse side of the bill of lading so that its history of handling is easily traced.

When a bank at Montreal delivers bills of lading to a grain broker or forwarder acting for the owner of the grain, the bank receives a trust receipt which provides that the broker will return to the bank within a reasonable time ocean bills of lading for a like quantity and grade, and will return, on demand, the original lake bills of lading or their equivalent in ocean bills of lading.

After all lake freight charges against the grain have been paid, a broker desiring release of water-borne grain presents the bills of lading to the owner or agent of the vessel, who in turn issues an order to the broker advising the National Harbours Board or the respective licensees as to the quantity, grade and kind of grain to be released, specifying the name of the canal vessel so that they can readily identify the parcel referred to in the document. The vessel owner or agent then cancels the bills of lading in accordance with the quantity being released and returns them to the broker.

The broker then issues an order to the National Harbours Board with instructions to deliver to the ocean vessel a stated quantity and grade of grain. This order must be accompanied by release order (from lake carrier) as referred to above, together with the cancelled bills of lading. These bills of lading are further examined and retained by the National Harbours Board.

The grain office of the National Harbours Board issues an order containing instructions to the superintendent of the elevator, name of the vessel to receive the grain, the quantity, grade and kind of grain to be delivered and the names of the broker or forwarder and of the shipper.

When the elevator has made delivery, the elevator superintendent issues a ticket to the ocean vessel's wharf office, notifying them that grain is on board, giving particulars as to quantity, grade, stowage and owner.

Upon receipt of this ticket, the ocean carrier gives to the grain broker a dock receipt which is later exchanged for an ocean bill of lading, when properly prepared by the broker.

The broker deposits ocean documents with the bank and requests cancellation of the trust receipt to the extent involved. This completes the transaction.

On grain shipped by rail, the same procedure is followed with the exception that the rail carriers issue an order on the National Harbours Board to release the grain, but the railways retain the cancelled lake bills of lading.

Handling Grain Through U.S. Ports

Virtually all Canadian grain passing through United States seaports in quantities is carried by boats from the Lakehead to Buffalo, unloaded into elevators and placed in bond. It is then transferred to railway cars or canal barges, and forwarded to New York, Baltimore, Philadelphia, Portland or Norfolk. On arrival, it is generally unloaded into elevators, and from them delivered to the ocean going vessel.

Shipments of grain are insured when loaded at the Canadian lake ports. The shipper notifies the offi-

cial agents for the vessel at Buffalo of probable date of arrival of the boat. They notify the United States Customs Department and the elevator designated for unloading. An official of the Customs Department, known as "tripman" meets the boat on arrival, gives the captain permission to unload and notifies the superintendent of the elevator that he may receive the grain. The elevator companies, their head officials, and the transportation companies are bonded. The Customs Department relies on these bonds for security of the grain and exercises little actual supervision over grain in store until it is shipped from the elevator.

The identity of all cargoes is preserved and each cargo is specially binned unless the owners otherwise order. If the owner desires a mixture of cargoes of the same or different grades, the elevator interested requires a written order from the owner and consent from the customs officials to make the mixture.

Shipment of Bonded Grain

When bonded grain is shipped by rail from Buffalo elevators, the shipper requests the railway to contract to deliver the grain to the seaboard port, after which the railway office at Buffalo applies to the customs office there for clearance of the shipment to the seaboard port giving name of the boat which carried the cargo to the elevator and the quantities involved. Each shipment from the elevator is termed a "lot" and receives a distinctive number. The railway company instructs the elevator to ship via rail to the seaport designated, and the customs "tripman" authorizes the elevator to make the shipment. The railway company files with the customs office a manifest showing the lot number, weight, and number of cars in the lot. After completion of the shipment, if the weights do not tally with the weights of the cargo as declared to customs on arrival, they demand a statement of the overage left in the elevator. The Customs Department accepts the report on the overage, the check on a false report being the liability of the elevator to discovery through its employees and the heavy penalty incident thereto.

Any supervision exercised by the customs officials is to see that the duty is paid on any bonded grain in the elevator not cleared for export.

Bonded grain shipped by barge along the canal is handled in a similar manner, but the barge hatches are sealed by customs officials by running a wire through the staples of the hatches and sealing the ends with customs seals.

The Chambers of Commerce of the various seaports have salaried grain inspectors licensed by the Federal Government. When the grain reaches the seaport, via rail, it is spotted in the railway yards and a grain inspector samples the "lot", taking a five probe sample of each car, noting the weight and other particulars required by the United States system of inspection, and the condition of the grain. This sample and the record of the grain are taken for the protection of the port and are kept for sixty days. The consent of the Customs Department is necessary before the grain can be unloaded and the Department, in turn, checks the "lot" with the manifest filed with them by the railway company concerned.

On unloading, in order to satisfy the customers, the identity of each "lot" is again preserved in the eleva-

tor and the grain is specially binned. If the elevator is too full to allow for individually preserved "lots", the grain is usually held in cars until space is available, although occasionally the "lots" of like grade are combined.

Loading at the Pacific Seaboard

Grain moving to the Pacific Seaboard originates from stations in Alberta or those on the Saskatchewan border where rail differentials are favourable to this movement. Rail shipments to Victoria are ferried across from Vancouver at the same export rate as to Vancouver.

Rail bills are handled by their offices in Alberta and are forwarded by the banks concerned to their Vancouver branches. When cars are unloaded, the Vancouver office issues bailee receipts to the banks to withdraw the rail bills of lading, whereupon the rail freight is paid, and warehouse receipts issued by the terminal elevator companies are exchanged for the rail bills of lading.

The method of utilizing "car-leaves" for record purposes in the shipping office is quite complete. In some cases, the "car-leaf" is represented by a large envelope containing documents relative to the shipment of individual cars. In other cases, the "car-leaves" are kept in a binder (the docket being kept in an auxiliary file) and give a complete historical record of each car from the point of origin to its ultimate destination, whether interior terminals, mills or the terminals on the Pacific Seaboard.

Warehouse receipts, deposited in the bank from which the bailee receipts were issued, are held until the grain is loaded. When the grain is required, a further bailee receipt is issued to the bank and the warehouse receipts withdrawn. These are surrendered to the terminal elevators with loading instructions.

When the grain is loaded on board the ocean vessel, the ship's officer issues a mate's receipt for the quantity loaded, which is surrendered to the shipping companies by the authorized parties in return for ocean bills of lading. These in turn are deposited in the banks and attached to the invoice, marine insurance and inspection certificates and drafts are to be forwarded for presentation to the buyer. When these ocean bills of lading are deposited instructions are issued to the bank to cancel the Vancouver bailee receipts.

F.O.B. Shipments

Grain sold for export to the Orient is normally sold F.O.B. on steamer, and the Vancouver office receives ocean bills of lading or a mate's receipt on completion of loading, which are attached to the invoice. Drafts are drawn on the various buyers in U.S. or Canadian funds by telegraphic transfer through their designated offices.

Where F.O.B. sales or in store sales are concerned in Vancouver, invoices are made out and funds collected in Vancouver.

Export Shipments

Because of the excessive risk of grain going out of condition when exposed to the high temperature in the Panama Canal area, exports from the Pacific Coast must be straight grade unless the buyer assumes risk of shipment of tough grain.

Sales in this division are divided into F.O.B. or C.I.F., for shipment to the United Kingdom, the Continent or the Orient. The actual invoicing and

issuance of drafts and insurance certificates are generally processed through the head offices or western branches, with the exception of shipments F.O.B. Orient, which are completed at Vancouver. Drafts are discounted at the banks and are handled by them for collection. Calgary operates as a separate entity in the West, subject to the direction of its sales and administrative policies from the head office at Winnipeg or vice versa if the head office is located at Calgary.

Offers

The exporter is prepared to "offer" grain for export when disposition of grain has been effected at strategic points for movement forward to any seaboard destination where tonnage is booked. Firstly he must prepare the offer slate upon which are computed the elements of cost, lakehead fobbing (elevation charges), lake freight and brokerage, lake insurance and outturn, war strike and risk insurance, interior elevation, seaboard fobbing and brokerage, ocean freight, ocean marine insurance, ocean outturn or superintendence, interest and bank charges. Once these charges are determined, the exporter adds to them the value of the grain basis in store at lakehead terminals.

Export offers fall into two general classifications, the United Kingdom or Continent. The former, if covering wheat, is made in sterling so that the exporter must know the current rates of exchange on sterling in order to convert his dollar rate per bushel C.I.F. to sterling. In the latter, offers are made in dollars or other currencies per 1,000 kilos.

Cables offering the grain are sent to the importer subsequent to the close of the day's market. They are generally good for acceptance until the opening of the Winnipeg market on the next business day following. The importer cables his acceptance and certain routine procedures must then be carried out in the exporter's office.

Ocean Freight

It is customary when offering to secure "refusal" (option of loading) of the required space on ocean vessels for the quantities to be offered and to the centres to which offers are to be made. It is of utmost importance that the required quantity and grade of grain in good condition must be promptly available at strategic positions to fill orders for loading of ocean vessels. Should congestion occur at any point in this forward movement, heavy costs are incurred through inability to take up tonnage booked with the required grades and quantities of grain on the dates upon which loading must be effected. On occasion it is necessary to "take a position" on ocean freights and book forward freight contracts.

The first step is to book ocean freight, which is recorded in an ocean freight record. Record of sale is made in triplicate in a sales book. Copies are sent to the various departments affected, giving the buyer's name and address, quantity sold, grade, time of shipment, place and price. If for nearby shipment (to be made within a short time of sale), it will be entered in the order book and the forwarding agent at Montreal will be advised to load the quantity sold on board the ocean vessel specified. When the grain is loaded, the broker or agent at the forwarding office will forward full particulars to the exporter, giving the ship's name, date of bill of lading, quantity loaded, stowage, where destined and the bank in which docu-

ments are deposited. If for delayed shipment, the same procedure is followed, with the exception that shipments are classified and listed in order to take care of forward bookings under the required dates.

The exporter is then required to tender the necessary particulars to the buyer within a specific time after the date of the ocean bill of lading.

Superintendence

A firm of cargo superintendents is then advised to take charge of the unloading of grain at the overseas port, a copy of the invoice being sent to provide full particulars.

Shipments of wheat overseas are invoiced to the buyer on official seaboard weights as shown in the ocean bill of lading. The principal generally makes out the contract of sale and forwards two copies, signing one himself, the other to be signed by the seller and returned. For example, the grain contract of the London Corn Trade Association expresses the terms upon which sales of grain are made abroad and provides that deficiencies in bill of lading weights shall be paid for by the buyer; consequently the seller guarantees the outturn. In shipping to certain points in England, notably London and Hull, and almost uniformly in shipping to the Continent, the custom is to sell "full outturn guaranteed".

The risk incurred in guaranteeing outturn is considerable, for at many foreign ports facilities for unloading and weighing and methods of handling are quite inferior and prompt settlements of weight differences with buyers are difficult and frequently are disputed.

The contracts which exporters enter into with the superintendence company transfers the responsibility for the difference in outturn and the settlement of such differences from the exporter to that organization. The rates charged for this service vary as to port of destination and are detailed in the contracts made with clients.

The superintendence company assumes responsibility where shippers have booked ocean freights and sent grain forward unsold in the expectation of finding a buyer whilst afloat or upon arrival. In such cases where the shipper is required to discharge and store the grain the superintendence company, through its representative at the port of discharge, has been of service in this emergency.

Foreign Exchange

Where grain is sold for export shipments which are to be billed in foreign currencies, the exporter would be protected against loss by selling future exchange for the amounts involved. The customary procedure, taking a C.I.F. sale (United Kingdom) as an illustration, is to secure quotations from the various banks. The effect of selling sterling when cable acceptances on offers came in would be to assume the risk of fluctuations in sterling overnight, inasmuch as offers are based upon the market close, and cables are good until the opening of the Winnipeg market next day. Hence, during a period of unstable exchange values, heavy losses might be incurred. To obviate this difficulty, an element of speculation might have to be introduced and sterling sold on the basis of estimated sales determined by past experience. Exchange variations might then result in a profit or loss as the case might be, but any major decline would be largely offset. Sound judg-

ment is essential in handling foreign exchange under the respective due dates. Complete records must be kept, in which are tabulated quotations, sterling sold and covered and the net position on sterling.

Invoicing

Invoices in triplicate record particulars of:

(a) Contract, such as date, buyer, number, quantity, grade, price and basis.

(b) Loading, such as ocean vessel, bill of lading date, clearance port, destination and stowage.

(c) Financial aspects, such as bank through which documents are handled and foreign exchange conversion rate.

(d) Splits, (bill of lading splits in sets of specific quantities) unless otherwise stipulated by the buyer, insurance amounts and numbers. Insurance certificates are usualy made out for 2% over the value of the grain.

Drafts on buyers and/or collections are made out for amounts corresponding to the invoice. Ocean freight is deducted from the invoice to the United Kingdom as it is usually paid by the buyer on outturn quantity. Ocean freight to the Continent is prepaid on bill of lading quantity and is not allowed on the invoice.

The invoice, insurance certificate and drafts are deposited with the interested bank in Winnipeg, and the bank forwards them to its office at seaboard where the documents are attached to ocean bills of lading, inspection certificates, etc., and thence forwarded to the United Kingdom to be presented and are released by the bank when drafts are honoured by the buyer.

Payment on invoices to the Continent is usually by cable transfer on New York against presentation of the documents or prior to arrival of the vessel, but sometimes payment is net cash against shipping documents in New York against a sight credit, which may be either revocable, i.e. which can be cancelled without the consent of the beneficiary, or irrevocable, i.e. which cannot be cancelled without the consent of the beneficiary, opened with a first class New York bank or banker.

An "extension of shipment clause" is provided in the London Corn Trade Association form with regard to failure to fulfil contract, to the effect that if a shipper fails to load a contract within the specified time a penalty is stipulated.

Conclusion

The essential factors involved in the grain exporting and shipping business have been dealt with in as comprehensive a manner as an article of this nature will permit. It is of interest to note that the wheat futures market is not operative under the current regulations of The Canadian Wheat Board, nor can it be while fixed sales prices are determined by the Board.

The development of the St. Lawrence Seaway will cause a number of variations from the procedures outlined, more particularly in relation to ocean-going vessels and the routing of grain documents. The methods of operation may vary considerably but the fundamental principles involved will remain constant.

Taxes-Accumulation of Undistributed Income, Consolidations and Mergers

GEORGE G. RICHARDSON

So LONG AS CANADA imposes taxation at both corporate and personal levels, problems relating to undistributed income will always arise. This is of course also true under the taxation systems of most other countries and it is aggravated in some countries because the scheme of taxation gives less relief from duplicate taxation than does the Canadian scheme.

Before dealing with specific problems arising from the accumulation of undistributed income it may be of interest to discuss the historical background of the present legislation.

Historical Background

The Income War Tax Act, which was introduced in 1917, was gradually extended over the years to reach various types of transaction affecting undistributed income, which under the general law, would have been considered to be of a capital nature. Specific provisions were introduced to tax distributions to shareholders on winding up, reduction of capital, conversion into preference shares and loans to shareholders, etc. (all to the extent of undistributed income on hand) and premiums paid on redemption of preferred shares. Indirect transactions which might be considered to result in distributing income also became taxable, such as the following:

1. Dividends deemed to be received by another company on winding up.
2. "Indirect distributions of surplus" were taxable under section 14. This section provided that where a person owning shares transferred them to another company promoted or controlled by him and the acquiring company received a dividend from the acquired company which was applied to pay for the shares or to repay indebtedness incurred to acquire the shares, the dividend would be taxable against the person who transferred the shares.
3. When the Minister was of the opinion that a company had an undue accumulation he could notify the corporation under section 13 and if the excess was not distributed to shareholders within that fiscal period a dividend of that amount would be deemed to be paid by the company.
4. Extraordinary powers were given

This material was presented at the Tax Seminar, Queen's University, Aug. 27-29.

to the Treasury Board under section 32A to counteract the effect of any tax avoidance.

Under the then existing administrative system, which was based on the exercise of ministerial discretion, rather than the rule of law, and under which the officials of the Department exercised wide powers in the determination of income, the foregoing provisions assumed an importance greater than would otherwise have been the case.

While these and other provisions were designed to prevent the undistributed income disappearing without tax, accumulations of undistributed income were becoming a problem to taxpayers. Three major efforts were made to provide tax relief on the distribution of these surpluses. In 1930 an amendment permitted the distribution of 1929 surpluses on winding up without any tax whatsoever. This privilege was soon withdrawn.

By the end of the Second World War the problem of the accumulation of undistributed income in the family business had become acute and caused particular concern to the owners as to how the funds necessary to pay future succession duties could be raised. On the recommendation of the Ives Commission, provision was made in the case of companies having a limited number of shareholders (latterly 75) to pay, if they so desired, a tax at graduated rates of from 15% to 33% on the 1939 surplus of the company. This permitted tax-free distribution in the hands of the shareholders.

Relief from tax on income accumulated during the war was not given until 1950, when the well-known section 95A (now section 105) was passed permitting capitalization of surplus accumulated to the end of 1949 on the payment of tax at the flat rate of 15%. It was followed several years later by legislation enabling a company which received a stock dividend as a result of such a tax-free capitalization under section 95A to pass this on to its shareholders by similar action regardless of whether the recipient company had paid the section 95A tax on its own 1949 surplus.

The section 95A legislation was unique in being designed not only to free the accumulated surpluses existing at the end of 1949 but also to encourage a dividend policy for the future by offering the inducement that for every dollar which was paid out as an ordinary dividend a corresponding dollar could be given "95A" treatment at a 15% tax cost provided the company had made the necessary election with respect to its 1949 undistributed income or had no undistributed income on hand at that date.

In recent years the undistributed income problem has been partially relieved by the 20% tax credit on dividends from taxable Canadian companies which considerably reduces and in some cases eliminates double taxation.

Changes in Legislation in 1949

While these steps were being taken to alleviate the problem of accumulations, there were also major changes in the legislation dealing with the control of undistributed income. When the new Income Tax Act was passed, effective in 1949, it did not contain any provision similar to section 14 of the Income War Tax Act which dealt with indirect distribution of surpluses. Also it no longer imposed a tax on surpluses received by

one corporation on liquidation of another. Soon after the new Act was passed the provision which enabled the Minister to force a distribution to shareholders of excessive surpluses was repealed. The extraordinary powers given to the Treasury Board were however retained and a new discretionary power was given to the Minister to disregard artificial transactions in certain circumstances without the necessity of action by the Treasury Board. Other important changes were the following:

(1) A new concept by which on the acquisition of control of one corporation by another, the undistributed income of the acquired company at the beginning of the year of acquisition was labelled as designated surplus. Dividends paid out of designated surplus became taxable in the hands of the controlling corporation unless sterilized by the payment of the 15% tax under section 105. This legislation was similar in its objective to the old section 14 of the Income War Tax Act but more positive in its application.

(2) Abandonment of the attempt to tax individual holders at personal rates on premiums received on the redemption of preference shares. The old legislation had not been effective since the holders usually sold the stock to brokers or dealers in securities and the dealer paid tax on only his net profit on the transaction. This situation was corrected by imposing a tax of 20% or 30% on the premium on stock redeemed or purchased but payable by the company instead of by the recipient.

(3) The effectiveness of the provisions by which the undistributed income portion of any moneys received on winding up or otherwise was deemed to be a dividend had been somewhat impaired by the fact that the taxable income of brokers and security dealers includes gain or loss on purchases and sales of securities. In the case of an incorporated dealer this provision might even reduce the taxable income because it had the effect of reclassifying as a dividend part of an amount otherwise taxable as a trading profit. This made possible the liquidation of companies in which their surpluses disappeared through the trading accounts of the dealers without being subject to income tax on anything more than the net profit realized by the broker on the transaction – perhaps only a small fraction of the undistributed income of the company. Two amendments were designed to deal with this: (a) a provision under which a corporation dealing in securities could not claim the usual inter-company exemption on dividends received from another corporation and also claim a loss on the sale of those securities – (it must choose to claim one or the other); (b) a new section 105B enacted in 1955 imposed a 20% tax on designated surplus distributed by a corporation in circumstances in which control has been acquired by a trader or dealer in securities and 15% when control is acquired by a non-resident corporation or by an exempt taxpayer. (The tax is not imposed when the exempt taxpayer acquires control by gift or bequest). This legislation in effect sanctions the distribution of undistributed income through the medium of an investment dealer at the relatively moderate price of a 20% tax.

The reason for these provisions in the case of exempt taxpayers such as charities is more difficult to under-

stand. To retain their charitable status (which is of the greatest importance not only to the charitable organizations but also to their contributors) they must devote all of their resources to the charitable activities which they carry on. Yet this provision invites them to engage in transactions which seem to go beyond mere investment and come close to engaging in a business activity of buying companies for the purpose of liquidating them.

Some specific problems relating to accumulations of undistributed income, particularly as they affect public companies, are discussed below.

Section 105 Tax on Public or Semi-Public Companies

Undoubtedly section 105 is one of the most important reliefs available to the shareholders of private companies in dealing with problems arising from accumulating surpluses. It has not proven to be of great interest to the shareholders of public companies who are ordinarily more interested in regularity of dividends and appreciation of capital than they are in distributions of capital. Also in the case of widely held companies some shareholders with high marginal rates would benefit, while others, whose rate of tax on dividends is less than 15% (after taking the 20% dividend credit into account) would not. The fact that Canadian corporations and non-residents are not benefited by the payment of the tax is no doubt a further restraining influence.

There are, however, semi-public companies where control or practical control rests in the hands of a few shareholders. Here the use of section 105 elections may be of interest, especially in connection with the privilege to elect on an amount equal to taxable dividends. This, of course, is only open to a company if it has already elected on its 1949 surplus. If such an election has not been made or if it is inadvisable, the difficulty could be overcome by setting up a new holding company whose shares would be offered in exchange for the shares of the operating company, leaving it open to the holders to accept or reject the offer. Any holder who would be adversely affected by paying the section 105 tax could reject the offer. The new company would have no 1949 undistributed income on hand and would be in a position to make the section 105 elections on an amount equal to taxable dividends. It would be important that in the end result the new holding company is not controlled by one person together with members of his family since in these circumstances it would be a personal corporation. Also, if future earnings of the operating company were less than the dividends it pays, a problem of designated surplus might arise.

Purchase of Businesses

Some of the most common problems found in connection with undistributed income arise on the purchase of a business whether it be by a public company or by a private company. The question invariably comes up as to whether assets or shares should be purchased. In this decision some of the prime factors are:

(1) What would be the cost to the existing shareholders of distributing the present surplus of the company if assets were sold?

(2) By what amount would the basis for future capital cost allowances be increased or reduced by a purchase of assets? Broadly speak-

ing this resolves itself down to the question of whether the proposed price is greater or less than the total of the values of the net assets recognized for tax purposes in the hands of the existing company.

(3) What would be the tax consequences of a sale of assets at the proposed price as to possible tax on recapture (or terminal loss) and what would be the effect of such income or loss on the shareholders' tax problem in item (1)?

(4) Is part of the purchase price to be financed by borrowings, the interest on which would not be deductible if shares are purchased?

(5) Is there an excess of cash or investments in the company and can they be used effectively in the face of the designated surplus provisions if shares are purchased?

(6) Is there a problem of financing the purchase which requires that obligations be secured on the assets?

These factors must be balanced up based on the circumstances of each case. As time goes on more and more depreciation becomes subject to recapture and the price for a step up in the base for future depreciation allowances becomes greater. The purchase of assets thus tends to become less attractive.

Amalgamation by Statutory Merger

A very common problem involving accumulations of undistributed income is that met in the amalgamation of two or more companies, the term amalgamation being used here in the sense that the interests of both of the existing sets of shareholders are continued in a new or continuing company. One of the most interesting methods of effecting an amalgamation is the statutory merger procedure which is available to companies under section 96 of the Ontario Corporations Act. Unfortunately, to qualify both (or all) of the amalgamating companies must be incorporated under Ontario charter. The procedure is for the shareholders of the amalgamating companies to ratify an agreement setting out the terms of the merger, who are to be the directors of the continuing company and how the capital stock of the two companies is to be dealt with. Supplementary letters patent are then issued by the Provincial Secretary confirming the terms of the agreement. Thereafter the corporations continue as a single company which automatically possesses all the assets of the amalgamating companies and is subject to all their liabilities. Neither company obtains control of the other nor is distribution made to shareholders. Rather, what transpires is a marriage of the companies. Accordingly mergers of this kind have been accomplished without tax on distribution or the creation of designated surplus. However, the taxation authorities appear to view these amalgamations with some misgivings and their attitude on a number of questions such as loss carry-overs seems to be uncertain, if not unfavourable.

Amalgamation by Exchange of Shares

Where a statutory merger cannot be effected a similar result, so far as continuing both interests is concerned, may be obtained by the issue of shares of one of the companies in exchange for shares of the other company. The result of course is a parent-subsidiary relationship with perhaps some minority interest still outstanding in the subsidiary which may be undesirable.

From an income tax point of view

a serious problem may arise from the designated surplus provisions if it is desired to utilize the funds of the acquired company or to pool all of the assets and operations as though there were a single entity. It may be possible (at a price equal to the 15% tax on the 1949 undistributed income) to sterilize the designated surplus and thus permit the liquidation of the subsidiary company into the parent. But if the subsidiary has substantial undistributed income accumulated since the end of 1949 it will be ineligible for section 105 elections on that amount, even though it has paid the required amount of dividends since 1949, unless the election is made prior to one company becoming the subsidiary of the other, which is not always possible. Earnings arising after the acquisition of the subsidiary company may of course be paid out free of tax.

Designated Surplus Concept

It seems questionable whether the present obstacles created by the designated surplus provisions to the integration of the businesses of two or more companies are justified. In the remarks made by J. Grant Glassco to the Royal Commission on Canada's Economic Prospects the proposition was put forward that there should be no barrier to the amalgamation of an acquired subsidiary with its parent provided the combined undistributed incomes of the two companies still exist in the continuing company. He also raised the question as to whether it was desirable to require the use of an investment dealer to qualify for the liquidation of surpluses at a cost of 20% rather than permitting such surpluses to pass directly from one company into another at a tax cost of 15% or 20%.

Taxable Stock Dividends

When stock dividends are paid (other than those paid out of tax-paid undistributed income after electing to pay the section 105 tax), section 81 provides that the amount taxable is the lesser of the amount of the dividend or the undistributed income then on hand. But this raises the question as to what is the amount of the dividend, particularly if it consisted of say 1/25 of a share of no par value for each no par value share already outstanding. It seems reasonably clear that in these circumstances the amount taxable is the amount which is capitalized. This is consistent with the fact that the amount of surplus which is thereby removed from distribution is limited to the amount which has been transferred from earned surplus to share capital account.

Reorganization, Conversions and Reductions of Capital

Reorganization of corporations in financial difficulty or which for other reasons require a readjustment of their share capital structure involves a wide variety of considerations which it is not possible to explore in detail here. The principal provisions which have to be faced are those in section 81 and section 24. (The latter deals with securities issued in satisfaction of an income debt). The provisions of subsection 1 of section 8 dealing with payments, benefits, etc. are not applicable on reorganization of share capital.

Conversions of preferred into common shares are not taxable but when common shares as defined in the Act are converted into shares other than common shares, tax falls on an amount equal to the lesser of the holders' share of undistributed income on

hand or something which is vaguely referred to as "the amount received or the value of that which was received by him for or in respect of the shares or the . . . . conversion".

Reductions of share capital to extinguish an accumulated deficit by cancelling part of the existing capital do not raise any question of tax since nothing is received by the shareholders. On the other hand reductions of capital in which assets of the company are distributed to shareholders in partial repayment of capital result in tax on an amount equal to the lesser of the assets so distributed or the holders' share of undistributed income then on hand.

Winding Up

Problems arising out of winding up have been affected greatly by legislation in recent years. Under present legislation it would only be in circumstances where the shareholders have relatively small incomes that it would pay to make an ordinary distribution of assets to the shareholders. Where they are taxable in higher brackets less expensive methods can usually be found such as the use of section 105 to pay 15% tax on all or part of the undistributed income or of section 105B (i.e. selling the shares of the company to an investment dealer and liquidating the company at the price of a 20% tax plus an investment dealer's fee).

Problems of International Taxation of Foreign Investment in Canada

More complicated problems relating to accumulations of undistributed income arise when the ownership or control of the company is held by foreign investors, particularly foreign corporations. In these circumstances nothing can be more important than to visualize the total tax cost rather than looking only at the tax incurred in one or the other country. For the sake of simplicity this discussion is limited to cases where control is in the hands of a United States parent.

When a U.S. corporation receives a dividend from a Canadian company duplicate corporate taxation may be involved since the United States Internal Revenue Code has not gone as far as Canada in eliminating duplicate corporate tax. It does not give a complete exemption from U.S. tax for a dividend received from a Canadian company where more than a stated percentage of the shares are held by the U.S. parent. (Canada exempts foreign dividends from companies more than 25% owned.) The dividends are fully taxable but subject to two tax credits: (1) for the amount of the foreign tax withheld on the dividend itself and (2) for the corporate income tax paid by the foreign company on the profits from which the dividend flowed. There are of course rules for determining what rate of foreign tax shall be deemed to have been paid on profits and other mechanics involved in applying these credits. Broadly speaking, however, if a Canadian corporation has paid income tax at the rate of 47% on the profit from which the dividend was paid, then a U.S. corporate holder which owns more than 10% of the shares of that company will be entitled to a tax credit at the rate of 47% to offset against U.S. tax otherwise payable, along with a credit for the withholding tax. This same treatment is extended to subsidiaries of 10% owned foreign companies provided that more than 50% of the voting stock of such subsidiary is held by the 10% or more owned subsidiary.

Several facts of considerable importance are worth noting:

1. If a U.S. company has only a 25% interest in a Canadian company it will be advantageous taxwise to hold it directly rather than as a subsidiary of another Canadian company (otherwise income taxes paid on profits by the 25% owned company will not be eligible for the U.S. tax credit).
2. If a U.S. company holds less than a 10% direct interest in a Canadian company or less than the stipulated 50% interest in a sub-subsidiary the absence of a tax credit may involve a duplicate corporate tax which will be prohibitive.
3. It may be illusory for a Canadian subsidiary to invest in small holdings of Canadian equities on the assumption that freedom from Canadian tax on the receipt of dividends by the subsidiary is the happy end of the matter. The average rate of income tax paid by the Canadian subsidiary is diluted by the tax-free income perhaps to the point where on transfer of these earnings to the U.S. parent by way of dividend, the tax-free Canadian dividends become subject to full U.S. corporate income tax.
4. A similar illusion may arise in connection with capital gains realized by a Canadian subsidiary. When the dividends flow from profits of a year in which non-taxable capital gains have been realized, dilution of the rate of tax credits available to the U.S. parent will again result. The capital gains, though free of tax in Canada, may become subject to a 52% tax in the U.S. (rather than the lower rate payable in the U.S. on capital gains) if the credit is diluted to the point where the combined credits fail to cover the gross U.S. tax payable.

A BRITISH ACCOUNTANT'S SUGGESTION

Letter from taxpayer enclosing payment on account of instalment of Schedule D tax: –

"As my wife gave birth to a third child on August 12 on the suggestion of my accountant Mr. A. B., I enclose £9 10s."

—W. W. Jones in *Taxes*, September 1956

Edited by LAWRENCE G. MACPHERSON, F.C.A.

Accounting Research

Director of Research, C.I.C.A.

THIS ISSUE inaugurates a new policy for the Accounting Research department of *The Canadian Chartered Accountant*. Those readers, (and our impression is that they are legion) who have regularly turned to this section in the sure knowledge that the article written by Miss Gertrude Mulcahy would cast light on some matter of interest and importance need not be alarmed. She will continue to prepare articles that will appear under her name, but the burden of providing regular material on research matters will now be shared with others for at least some of the issues each year.

In communicating the results of the work of the Committee on Accounting and Auditing Research, reliance has had to be placed in the past on the distribution of research bulletins. Bulletins can be published, however, only after much research has been undertaken and substantial agreement reached. For some time, a need has been felt for a less formal outlet, where the work of the committee could be described and where subjects of interest might be discussed even when opinions had not been formed. It is now proposed to share this space from time to time with members of the research committee, and with other contributors who may be interested in projects which are on the agenda of the committee or which perhaps should be on it.

Contributions and suggestions relating to accounting research will be gladly received, and no narrow limits will be placed on the meaning of "accounting research". We are confident of the response from the members of the Institute, for our past experiences in seeking such help prove that accountants as a group are generous people.

Expansion of the program of the Committee on Accounting and Auditing Research has resulted in a heightened interest in this section by committee members. As evidence of this the chairman of the committee, Mr. Harold P. Herington, F.C.A., initiates the new plan this month with a timely discussion of some of the important aspects of Bulletin No. 10.

DEPRECIATION AND CAPITAL COST ALLOWANCES

H. P. Herington, F.C.A.

INCOME FROM a business according to the Income Tax Act is the profit therefrom. Basically then, it is the annual profit from the business which is the subject of taxation. However, in the process of assessment a number of statutory provisions and administrative regulations come into play with the result that rarely indeed does taxable income agree precisely with income from a business as an accountant would report it. In some cases, the difference is so great as to be noticeable in the provision

made for income taxes payable. Furthermore, the corporate rate of income tax is itself a variable. In this respect, there are three distinct groups of corporate taxpayers. In the first group are those companies whose taxable income, being $20,000 or less, are taxed at the relatively low rate of 20%. In the second group are those companies (including "associated companies" which agree to share the low rate) whose taxable income exceeds $20,000 in which case the rate varies upwards from 20% to a rate approaching but never quite reaching 47%. In the third group are those "associated companies" which do not share in the low rate and in consequence are subject to a flat rate of 47%. Companies whose statements are published fall for the most part in the second group. As an indication of the variations in this group there follows a table showing the effective corporate rate applicable to various levels of taxable income:

Taxable income	*Effective Rate*[1]
$ 25,000	25.4%
50,000	36.2%
100,000	41.6%
500,000	45.9%
1,000,000	46.5%
5,000,000 and up	46.9%

The variable character of the corporate tax rate is understood by most shareholders and does not call for any explanation in annual reports. Nor is it considered necessary to comment where the circumstances giving rise to a disparity between taxable income and reported income are consistently present year after year. For example, it is not usual to explain the effect on income taxes of such items as exempt income, disallowance of bond discount or allowance for unrecorded depletion.

Two other items, each of which has been the subject of a bulletin, affect income taxes, often to an important degree. They are business losses (Bulletin No. 12) and capital cost allowances (Bulletin No. 10). Business losses do not reduce income for the year as an expense does, but indirectly do affect income. Because they may be brought into account in the tax return they reduce and sometimes extinguish the income tax otherwise payable. The so-called tax saving is a permanent one and the deduction of the loss in the return has no bearing on any future return. Bulletin No. 12 merely indicates how the tax saving may be brought into account without detracting from the main purpose of the statement of income which is to report the results of the year's operations.

It is now universally understood that no true profit can be shown unless there has been charged an amount for accruing depreciation and it is generally accepted that the charge should conform to a rational and orderly plan for amortizing the cost of the fixed assets over their useful economic life. The deduction of depreciation for income tax purposes prior to 1949 was not a matter of right but a matter of administrative discretion. Except in those cases where there had been a revaluation of the fixed assets, a basis of providing depreciation acceptable for accounting purposes usually met the requirements of income tax practice. Since 1949 depreciation, as such, is not deductible under the Income Tax Act but in lieu thereof there may be deducted capital cost allowances subject to the ra-

[1] 20% on $20,000; 47% on remainder

ther extensive provisions of Regulation 1100.

This new approach to depreciation created a problem in annual reporting and a feature of the regulation contributed to the difficulty. The right to capital cost allowance was recognized only if and to the extent recorded in the books. In consequence of this requirement, the charge for depreciation was often in excess of a proper charge. Exception was seldom taken by the auditors in their opinion unless reference to an explanatory note in respect of the basis of providing depreciation can be regarded as a qualification. Indeed, more often than not, the notes were so phrased as to give the impression that the conservative accounting procedure was a matter for congratulation. In brief, there has been too ready acceptance by the accounting profession of capital cost allowances as a substitute for depreciation and in this respect accounting principle has given way to expediency. With the repeal of Regulation 1100(4) an opportunity was given to restore to financial statements generally accepted accounting principles insofar as depreciation was concerned, an opportunity which the profession should be eager to accept.

Companies which record appropriate charges for depreciation in the statement of income and claim in their income tax returns capital cost allowances to the extent permitted sometimes experience wide variations in the amount recorded and the amount claimed with material distortions of income first in one direction and then in the opposite direction. Bulletin No. 10 on "Depreciation, Capital Cost Allowances and Income Taxes" is an attempt to overcome this situation.

Of all the bulletins which have been issued by the Committee on Accounting and Auditing Research of The Canadian Institute of Chartered Accountants, Bulletin No. 10 is perhaps the most interesting. Other bulletins merely reaffirmed or clarified established accounting principles, whereas Bulletin No. 10 may well have established a new principle. If so, it is important that this bulletin receive whole-hearted acceptance not only by the profession but by its clientele.

The growing importance of the income account and in particular the significance of the figure of net income for the year is now recognized by the profession, and in the preparation of the bulletin the committee first directed its attention to the income account. A statement of income to be useful must lend itself to a comparison of the results it shows with those of preceding periods. It follows that its preparation must have in all material respects the quality of consistency in the application of accounting principles. Reference has been made to differences between taxable income and income reported to the shareholders. Where the difference is not material or, if material, is consistently present year after year there is perhaps no need for comment unless an explanation is necessary to a proper understanding of the financial statements. The disparity between capital cost allowance and depreciation on the other hand may follow an irregular and unpredictable pattern, making comparison of results from one year to another difficult. Explanatory notes often do no more than offer the reader an alternative computation of income and leave him in doubt as to the computation preferred by the auditor.

It was natural that a bulletin which seemed to depart from traditional accounting should receive more than usual attention. The discussions in Halifax and an article[2] in the magazine indicated substantial acceptance of the bulletin but there appears to be some misunderstanding in regard to the application of the suggestions it contains.

The article referred to presented an interesting exercise in arithmetic but the assumptions were somewhat unreal. It is doubtful if the capital expenditures of many companies would follow a clear pattern of growth. If, as the article suggests, Bulletin No. 10 only applies to a single asset it would have had such narrow application that its issuance could hardly have been justified. Capital cost allowance is computed by reference to a class of fixed assets. It may relate to a single asset such as a building but it would be most unusual to have but a single asset in, say, class 8. Fixed assets in a financial statement usually represent a series of acquisitions over a period of years. The acquisitions of each year account for a portion of the charge for depreciation and for a portion of the capital cost allowances. Capital cost allowances on current acquisitions are inevitably greater than straight-line depreciation. On acquisitions of prior years capital cost allowances are greater than, almost equal to or less than straight-line depreciation according to the time elapsed since acquisition. Financial statements do not disclose these conflicting trends but only their net effect and it may be that opposite effects are in equilibrium or nearly so. When that happens Bulletin No. 10 continues to apply, but its application may not be apparent.

So great has the effect of income tax on the net profit from a business become that it is commonplace to think of items of income and expenses in terms of their individual effect on the item of income tax itself. Hence the impact of a particular charge for depreciation on income is frequently reckoned to be approximately half the amount because of the assumed saving in income tax. This conclusion is a valid one as to the items of expense which with relatively few exceptions are deductible for tax purposes. Depreciation differs from other expenses in that it is not itself allowed as a deduction. Rather a deduction by way of capital cost allowance is permitted in lieu of depreciation. Now if depreciation incurred and capital cost allowance were always the same in amount, there would be no problem and no need for Bulletin No. 10, but they rarely do agree unless, of course, the taxpayer chooses to consider capital cost allowance a reasonable substitute for depreciation, which it seldom is.

In the long run accumulated provisions for depreciation will correspond to the aggregate capital cost allowances claimed. It follows that if the allowances claimed are greater than depreciation recorded in any year they will be less in some future year. It follows, also, that in these circumstances income taxes will be less in the earlier years and greater in the later years than they would have been if based on income recorded in the accounts. As a practical matter it must be assumed for this purpose that the effective rate of income tax will remain the same for a

[2] "A Look at Depreciation and Income Taxes", by J. W. Crowe, *The Canadian Chartered Accountant*, July 1956.

relatively long period and if that should be the case income taxes in the long run will be the same however capital cost allowances may be taken.

The diminishing balance method of computing depreciation is acceptable provided the rates are such as to amortize the cost of the asset over its useful economic life. The rates will not necessarily be equivalent to the rates applicable to capital cost allowances and in any event the charge for depreciation under the method should only accrue from the date the asset is placed in service. That method may to a degree minimize but would not altogether dispose of the difficulty which Bulletin No. 10 is designed to overcome. Depreciation whether under the diminishing balance or straight-line methods can differ materially from capital cost allowances in the first years following acquisition. It is not without significance that the straight-line method was almost universally followed until 1949 when the price of adherence to that method, in the form of increased taxes, was greater than most companies could afford. With the removal of the restriction of capital cost allowance to the amount recorded, more and more companies have reverted to the basis of providing depreciation best suited to their individual circumstances. It is for those companies that Bulletin No. 10 is intended. It is for them that the bulletin should be retained.

HEWERS OF WOOD AND DRAWERS OF WATER

There are relatively as many people employed in Canadian manufacturing industries and as much money earned in them as in the United States. Canada is now one of the most industralized countries in the world, second only to the United States in terms of industrial production per capita. In terms of total value, Canada is among the six leading industrialized nations of the world (after the United States, the United Kingdom, Western Germany, France, and, presumably, the U.S.S.R., again measured in terms of national income originating in manufacturing industries). This is a remarkable achievement for a country comprising only about three-fifths of one per cent of the world's population, considerably smaller than the other leading industrialized nations.

The evidence lends very little support to the argument that Canadians are still hewers of wood and drawers of water.

—O. J. Firestone, Dept. of Trade and Commerce, quoted in The University of Western Ontario *Business Quarterly*, Winter 1956-57.

BY GEOFFREY H. WARD, C.A.

Practitioners Forum

Opportunities for Sole Practitioners

Now that a fresh crop of chartered accountants has just been harvested, this is perhaps an appropriate time to consider the opportunities available for starting one's own practice.

There is undoubtedly room for more chartered accountants practising as sole practitioners or in smaller firms. The growth of Canada and the increasing demand for accountants' services is providing greater scope in this field. However, since World War II a great many accountants have already started out on their own, and it is now difficult to find a town of any size that does not have a resident public accountant, probably a chartered accountant.

Although it might be difficult to spot a location where there is an obvious need for a practitioner, careful study probably would disclose some places. Of course, the larger centres can always absorb another accountant, but the larger the centre the better the service at present available, and hence the tougher the competition.

Getting Started

To get started on your own in public accounting, as in any other business, certain basic requirements must be met. These are capital, clients and staff.

Helpful information regarding capital requirements can be gleaned from the "C.P.A. Handbook", "The Successful Practice of Accounting" by Bacus, and "The Accountant's Office Manual" by Rockey. From $5,000 to $10,000 capital may be required to start, not only for investment in furniture and fixtures and for working capital needs – work in progress and outstanding accounts – but also to cover operating expenses for the first year or two.

Expected sources of clients should be specifically considered. You may have friends upon whom you can count for a certain amount of business. If you plan to move into a new community, choose one that really needs another accountant and does not have adequate service available. Obtain assurance from the local bankers and businessmen that they will support your endeavour to supply a needed service to their business community.

You may make an arrangement with another practitioner to buy his practice. However, that is not always easy to do. Practices for sale are few and may be undesirable or high priced. Also several accountants will probably be interested in buying any practice that is available. Alternatively, you may make an arrangement to go into partnership with another practitioner with a view to succeeding him. In any case a definite plan is most important. To just start out on your own without

any plan for obtaining clients is a hard way to get established.

The third main requirement is staff. Of course staff will not be a problem at first, as no doubt you can do everything yourself. However, it is not economical for a chartered accountant to be doing a junior's work. Also arrangements have to be made for typing.

When the time comes for acquiring staff you many find it extremely difficult. Accounting students are hard to obtain these days, and the new small firm is competing with larger well established firms who are in a position to pay higher salaries. As a matter of sound business policy, you cannot expect to get value from your employees without their cheerful and intelligent cooperation. You should not hire any assistants whom you cannot pay at the going rate plus an occasional bonus for good work. It would be better to refuse engagements than to chronically over-work or under-pay your staff. No good results can be expected by the beginning practitioner who attempts to "get by" financially by "squeezing" his staff.

The work performed in the larger firms' offices usually provides better experience for senior students. However, some of the smaller firms offer training that is more valuable to a beginning student. There will be more bookkeeping work to do. Most of the clients will be small businesses where a junior can more readily grasp the overall picture. He will reach the stage of taking charge of audits sooner because they are smaller. Also he is more likely to be working on the job with a partner. Provided that the student intends to go into practice for himself or become a partner with his employer, he may be wise to remain in the small firm.

In any case, as a prospective sole proprietor you can expect to have problems obtaining staff. These days you will probably have to settle for staff with lower qualifications than you would like. However, your long range success will depend very much on your ability to teach your staff to do creditable work that your clients will appreciate.

Disadvantages

In going over the steps required to get established you can see that there are some disadvantages to being on your own. It is a hard struggle and means a sacrifice of income. Also there is considerable risk; you are very vulnerable if, for example, you are sick or lose any one of your key employees. If you are relying too much on a few key connections for clients you may be badly disappointed and your professional independence may be endangered. Rapid early progress cannot compensate for ultimate lack of stature. You have to resolve that this is what you want for your life's work before starting on such a venture. On the other hand, if there is a partnership opening in the firm which now employs you, you can have a relatively easy start.

Choice of Career

The choice of a career generally should be taken very seriously and considered entirely from a long term standpoint. If someone offers you a job at $100 a month more than you can make on your own, it does not necessarily mean you should take that job. You should have a plan as to what you want to do for the rest of your life, and you should make sure that every position you accept not

only provides you with an income on which to live, but also moves you along the road to your ultimate goal.

A chartered accountant employed in public practice may move into industry almost anytime. Accordingly his plans may remain flexible before he makes this jump. However, the reverse move from industry to practice is rare and is technically much more difficult. Of course, two or three years in public accounting after graduation is essential. A person who has just graduated is really not ready to set up his own business. He needs experience and maturity.

Different aptitudes are required for different fields. The necessary requisites for a top-flight big business executive are not those required for a successful accountant with a small public practice. If you have the typical public accountant's interests it is doubtful whether you would get to the top in industry, or be happy there.

In an article "What Manner of Man is the Average Accountant?" in *The Journal of Accountancy,* April 1954, the Kuder vocational and personal preferences of public accountants are set forth. Particularly notable are preferences for avoiding conflict and an interest in detail and literary pursuits.

Therefore, if you are suited for public practice, in the long run you will not suffer any loss of income from choosing it as your career, and you will gain a great deal of personal satisfaction and happiness.

Advantages

Finally, it is worth considering the advantages of having your own firm where you enjoy an equity in and control over the policies and management of the business. On being asked their reasons for practising in smaller firms several accountants all mentioned their independence. That is something we seem to prize very highly.

Another important advantage is that your cash income directly reflects your own effort; that is, any profit coming from a good job you do will accrue directly to you. In addition, you are building up a business in which you will have an equity. If you work for somebody else, you may have a generous salary and bonus and pension plan, but when you leave, you leave the business behind. The practitioner who builds up his own practice has an asset he can sell. When he dies, he will leave an estate. A practice grossing $25,-000 a year, and it is quite reasonable to expect eventually to build up such a volume in a smaller community, may have a value of $25,000 or perhaps more. That is a not inconsiderable asset to have accumulated.

One of the other advantages lies in freedom to choose where you will live. If you pick a small community living conditions can be much more pleasant, and there will be a better opportunity to become a community leader than in a city. Admittedly the income ceiling is lower, yet many people wonder why they have stayed in a large city, with its hustle and bustle. They envy their country cousins who enjoy leisurely rural life.

There is also a difference between the nature of the services rendered by large and small firms. Most of the work of the larger firm is often straight-forward auditing engagements with, of course, some tax, prospectus and S. E. C. work. Now with small businesses, the statutory en-

gagements are less important and there is greater need for personal tax work and for management accounting and advisory services. You can act as a controller to many little businesses and become the leading financial adviser in your community. You have a chance to participate actively in decisions that are made, and to establish close personal relationships with your clients. This can be very satisfactory and at the same time quite remunerative financially. Both large and small firms have an opportunity to train fine young students for the profession. This too can be a very rewarding and worthwhile experience.

Conclusion

Without trying to promote the advantage of a smaller practice I do advise any recent graduate choosing a career to make his decision on a long term basis. He should pick the career in which he is most interested and for which his personal abilities best qualify him. That is where he will be most successful.

(*Thanks to F. H. Buck, F.C.A., C. L. King, F.C.A., and W. G. Leonard F.C.A. who read over the draft of this column and made many valuable suggestions. Their help is appreciated.*)

Readers of this department are cordially invited to correspond with the writer on any subject of interest to the practitioner.

INSTITUTIONAL ADVERTISING

Beside a picture of a human backbone from a skeleton the following copy appeared:

"This is a backbone.
You can't run a good advertising agency
without it.
It often makes you say an honest 'no'
to a client instead of an easy 'yes'.
It means giving service instead of
servility.
Very often, the result is outstanding
advertising."

From Young & Rubicam, Inc. advertisement in *Fortune*, July 1956. One could quite appropriately substitute the word "auditing" for "advertising".

BY MELVILLE PIERCE, B.A., LL.B.

The Tax Review

Isolated Commercial Ventures

Anything which throws light on the vexed question of the capital gain is welcomed by tax practitioners, and accordingly the recent judgment of the President of the Exchequer Court of Canada in *Minister of National Revenue* v. *Taylor* is deserving of appreciative comment. This was an appeal from a decision of the Income Tax Appeal Board pronounced by Mr. Fisher in December 1953, whereby the taxpayer was found innocent (a term used advisedly if inaccurately) of having made a taxable profit in connection with the sale of 1500 tons of lead to a company of which he was both president and general manager. That decision has now been reversed by Mr. Justice Thorson in the Exchequer Court on October 16 last, and the judgment pronounced is most illuminating.

Taylor, the taxpayer involved, was president and general manager of a Canadian metal fabricating company which was the subsidiary of a U.S. parent company. The parent company had established a firm rule that supplies of lead were only to be purchased to meet orders actually in hand, and that purchases of futures were prohibited. This, coupled with the circumstance that the Canadian company was obliged to purchase all its lead from the sole Canadian supplier (which was alleged to be other than easy to get along with at the time in question) led to restricted supplies for the Canadian company, to a pricing policy which made export business unattractive and also to the embarrassment of Mr. Taylor. As a result of this situation, when the latter saw an opportunity in 1949 to purchase abroad a large quantity of lead following a sudden sharp drop in the market (from 20¾c a lb. to 11¾c. a lb.) he endeavoured to persuade the U.S. parent company to authorize the Canadian subsidiary to make the purchase of foreign lead. The U.S. parent remained inflexible in its policy, however, but authorized Taylor to buy 1500 tons of lead at his own risk, the U.S. parent apparently undertaking that the Canadian subsidiary would buy it from him as and when required at current market prices. Taylor proceeded to carry out the purchase of the foreign lead through brokers and arranged for the sale of the lead to the Canadian company at the current market price on the date of its arrival. The lead was purchased in Jugoslavia in June, 1949 and on arrival in New York in August was delivered, part to the Canadian company's Montreal plant and part to its Toronto plant. The purchase price of the lead was in actual fact entirely put up by the Canadian company, and Taylor's profit on the transaction was in excess of $80,000. His motive in putting through the transaction was not basically a profit for himself, but really to further the Canadian company's interests, to teach the Canadian supplier what Taylor regarded as a much needed lesson, to reestab-

lish his reputation with the U.S. parent, and in part also to make a gain.

Taylor was assessed to income tax on his profit, but Mr. Fisher of the Income Tax Appeal Board held that the gain was non-taxable as being a capital gain. Taylor, said Mr. Fisher, did not enter the transaction with the hope and expectation of making a profit but for the other purposes above described. The transaction was therefore, he said, not an adventure in the nature of trade but an isolated transaction entered into without the intention of making a profit in any event out of the transaction. Accordingly, held the learned judge, the profit was of a capital nature and not taxable.

Mr. Fisher, it will be noted, decides in the above judgment that an isolated transaction of purchase and sale of property is not an adventure in the nature of trade if it was entered into without the intention of making a profit in any event out of the transaction. The Minister of National Revenue appealed, and the neat question at issue in the appeal was whether Taylor's profit on the above transaction was taxable notwithstanding that profit was not the real purpose of the transaction even though a profit resulted. In other words, the appeal was concerned directly with the doctrine of intention, namely the view that intention to make a profit on the resale of property purchased with that intention clothes the resulting profit with the character of income.

In his judgment on the appeal Mr. Justice Thorson intimates that the intention of the taxpayer in this type of transaction is not the real issue. The prime question is, he states, whether the purchase and sale of the 1500 tons of lead by Taylor amounted to an "adventure or concern in the nature of trade" within the meaning of that phrase as used in s. 127(1)(e) of the Income Tax Act, and he goes on to point out that "an adventure in the nature of trade", a phrase taken from the British Income Tax Act, extends the field of taxation. Going then to the British taxation cases in which that phrase was construed the learned President of our Exchequer Court makes the following points:

1. The sale of an ordinary investment at an enhanced price does not render the profit taxable unless the sale was not merely a realization or change of investment but "an act done in what is truly the carrying on, or carrying out, of a business" or "a gain made in an operation of business in carrying out a scheme for profit-making": *Californian Copper Syndicate Ltd.* v. *Harris* (1904) 5 Tax Cas. 159, per Lord Justice Clerk at p. 165.

2. A single isolated transaction of purchase and sale *may* constitute an adventure in the nature of trade or a "scheme of profit-making" within the sense of the term employed by the Lord Justice Clerk in the above decision. See e.g. *Beynon and Co.* v. *Ogg* (1918) 7 Tax Cas. 125.

3. A speculative purpose lends support to a finding that a sale of producing-income property amounts to a trading transaction rather than a mere realization of an investment.

4. The profit on an isolated venture of purchase and sale is only taxable provided the venture is "in the nature of trade", and the isolated purchase of some article against an expected rise in price followed by its sale at a higher price is not of necessity "in the nature of trade" unless

carried out in the same way as it would be by a dealer in such articles. *Com'rs of Inland Revenue* v. *Livingston* (1926) 11 Tax Cas. 538 per Lord Clyde.

5. The nature and quantity of the subject-matter of the transaction of purchase and sale may by themselves be sufficient to fix the transaction with the character of "an adventure in the nature of trade", as e.g. where the transaction in question is the purchase and resale of a large quantity of toilet paper, as in *Rutledge* v. *Com'rs of Inland Revenue* (1929) 14 Tax Cas. 490, or a large quantity of whiskey as in *Com'rs of Inland Revenue* v. *Fraser* (1942) 24 Tax Cas. 498, esp. per Lord Normand at p. 502, and see *Com'rs of Inland Revenue* v. *Reinhold* (1953) 34 Tax Cas. 389, per Lord Carmont at p. 392; or of a spinning plant as in *Edwards* v. *Bairstow* (1955) 3 All E.R. 48.

6. The fact that the transaction in question is an isolated one does not prevent it from being an "adventure in the nature of trade": the word "adventure" implies a single transaction. It is *the nature* of the transaction, not its isolation, that determines.

7. It is not essential to constitute a transaction an adventure in the nature of trade that an organization be set up to carry it into effect: *Rutledge* case, *supra,* and *Lindsay* v. *C.I.R.* (1932) 18 Tax Cas. 43.

8. Nor is it necessary that anything be done to the subject matter of the transaction to make it saleable: *Rutledge* and *Lindsay* cases, *supra.*

9. Furthermore, it is immaterial that the transaction in question is totally different in nature from any of the other activities of the taxpayer and that he has never entered upon a transaction of that kind before or since.

10. A transaction of purchase and sale of property may be an adventure in the nature of trade although the person entering upon it did so without any intention to sell its subject matter at a profit. For the intention to make a profit may be just as much the purpose of an investment transaction as of a trading one. Such intention may well be an important factor in determining that a transaction is an adventure in the nature of trade but its presence is not an essential prerequisite to such a determination and its absence does not negative the idea of an adventure in the nature of trade. The considerations prompting the transaction may be of such a business nature as to invest it with the character of an adventure in the nature of trade even without any intention of making a profit on the sale of the commodity. It is what the taxpayers did that must be considered and a declaration by him that he did not intend to make a profit may be overborne by other considerations of a business or trading nature motivating the transaction.

11. The question whether a particular transaction is an adventure in the nature of trade depends on its character and surrounding circumstances and no single criterion can be formulated. There are, however, some specific guides, set out hereunder.

12. If, for example, the transaction is of the same kind and carried on in the same way as a transaction of an ordinary trader or dealer in property of the same kind as the subject matter of the transaction it may fairly be called an adventure in the nature of trade: *Livingston* and *Rutledge* cases and *Edwards* v. *Bairstow, supra.*

13. And there is the further established rule that the nature and quantity of the subject matter of the transaction may be such as to exclude the possibility that its sale was the realization of an investment or otherwise of a capital nature or that it could have been disposed of otherwise than as a trade transaction: *Rutledge* case, *supra*, per Lord Sands, and *Rheinhold* case, *supra*, per Lord Carmont.

Following this elaborate review of the statute and the cases Mr. Justice Thorson concluded that Mr. Taylor's transaction in lead fell squarely within the decisions in the *Rutledge* case, the *Fraser* case and *Edwards* v. *Bairstow, supra.* The nature and quantity of the subject-matter of the transaction, namely 1500 tons of lead, excluded any possibility that the transaction was of an investment nature involving the realization of a security or resulting in a fortuitous accretion of capital or that it was anything other than a transaction of a trading nature. "The commodity itself stamped the transaction as a trading transaction." Moreover, Taylor dealt with the lead in exactly the same manner as any dealer in imported lead would have done, and this brings the transaction within the decision in the *Livingston* and *Fraser* cases, *supra.* It was, added the learned President, of no avail to Mr. Taylor that when he purchased the lead he did so without any intention of selling it to the Canadian company at a profit. Clearly he did not buy the lead for investment: all his reasons for buying it were business reasons of a trading nature; his adventure was a speculative one; it was a dealing in lead and nothing else.

One may be of opinion that this decision is not the final word on isolated transactions while regarding it as a valuable contribution to the clarification of a still murky subject.

BY J. E SMYTH, F.C.A.

Students Department

Associate Professor, Queen's University

THE QUESTION CORNER

It appears to me that under present Canadian practice a wide variety of methods and rates in calculating depreciation are "generally acceptable". For instance, a company may compute its provision on either the straight-line or the reducing balance method using a fair variety of rates for various classes of fixed assets. Auditors generally untrained in the technical question of depreciation seem to consider either method and various rates as equally acceptable as long as used consistently, and if satisfied that the provision is "adequate and reasonable" are signing their name to it. There is little doubt, however, that especially in the case of a new company, the difference between a 10% straight-line and a 20% reducing balance method of computation will have a major bearing on the financial statements and operating results.

Since the opinion of the auditor can cover such a wide variety of provisions and net book values of fixed assets and all under the same name "depreciation", why is it not practice or at least considered desirable to disclose on the financial statements the method used in computing depreciation provisions?

(Submitted by H.G., a student-in-accounts in Calgary)

Editor's Reply

It cannot be denied, we think, that published financial statements would provide more information were they to disclose the method of determining the amount of depreciation expense; just as we believe they would be more informative were they to disclose whether the last-in first-out, the first-in first-out or the average cost method had been used in determining the figure for cost of goods sold used in computing income.

On the other hand, the Companies Acts generally require that the income statement show the *amount* of depreciation expense for the year. A reader is then able to compare this amount with the balance sheet figure for fixed assets, and to obtain some measure of the company's depreciation policy by checking the relationship between the corresponding figures on the financial statements for previous years.

Section 87(1) of the Corporations Act (Ontario) also requires that "There shall be stated by way of note to the financial statement particulars of any change in accounting principle or practice made during the period covered that affects the comparability of any of the statements with any of those for the preceding period, and

the effect, if material, of any such change upon the profit or loss for the period." It is fair to add that, whether or not a companies act contains such a provision, an auditor would now regard it a part of his duty to comment in his report upon any significant change in accounting methods, where the financial statements themselves do not contain this information.

(Comments on this question and criticisms of the editor's reply are invited.)

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1955

Auditing I, Question 3 (11 marks)

The XYZ Co. Ltd. operates a branch in K. The branch maintains its own set of accounts which includes a head office account. The branch accounts are controlled by a corresponding branch account in the head office books.

CA is the shareholders' auditor of XYZ Co. Ltd. He found that at 31st March 1955, the company's fiscal year end, the balance of the head office account in the branch books did not agree with the branch account balance in the head office books.

CA's examination disclosed the following facts relating to the year ended 31st March 1955:

(i) Merchandise as required by the branch is shipped from the head office stock and charged to the branch at 15% above cost.

(ii) Building maintenance charges of $225 incurred and paid for by the branch were charged to head office account in the branch books and a debit note sent to head office to this effect. The debit note was disregarded by the head office accountant since management decided that the charge should be borne by the branch and not by head office. The branch had not been advised of this fact.

(iii) Head office sent goods to the branch costing $1,000 and in making out the inter-office invoice failed to add 15%. The invoice was inadvertently recorded in the branch books as $100.

(iv) It is the company's policy for head office to charge the branch with interest at each fiscal year end. This is calculated at 1% per annum on the year-end balance of the branch account in the head office books (before charging interest). Accordingly, at 31st March 1955 head office charged the branch with $972.50. This amount was recorded in the branch books as of 31st March 1955.

(v) Head office recorded and sent the branch a credit note for $200 representing 115% of the cost of merchandise covered by the note. In recording the credit note the branch added 15%.

(vi) Head office received $175 for the sale of scrap material belonging to the branch and credited the sale to office expense. No record of the sale had been made in the branch books.

(vii) Head office charged the branch with $600 as its estimated share of radio advertising. This amount was entered twice in the branch books.

(viii) Debit balance of the branch account in the head office books at 31st March 1955 was $98,222.50, after recording the interest charge of $972.50.

Required:

(4 marks) (a) A statement, showing your calculation of the correct inter-office balance at 31st March 1955 after giving effect to any adjustments which you consider necessary.

(7 marks) (b) Journal entries, complete with narratives, which you would make in the head office books and in the branch books to adjust the accounts.

A SOLUTION

(a)

XYZ CO. LTD.

CALCULATION OF CORRECT INTER-OFFICE BALANCE FOR BRANCH IN K AT 31 MAR 1955

Balance of Branch account in head office books at 31 Mar 1955 ..		$98,222.50
Add: Goods shipped to branch – additional 15% of $1,000	$150.00	
Correct interest on inter-branch balance at Mar 31 1955 at 1%	972.25	1,122.25
		$99,344.75
Deduct: Interest on inter-branch balance at 31 Mar 1955 calculated on wrong balance	$972.50	
Sale of scrap material	175.00	1,147.50
Correct inter-branch balance at 31 Mar 1955		$98,197.25

(b) ***Head office books***

		Dr.	*Cr.*
1955			
Mar. 31	Branch account	150.00	
	Suspense profit		150.00
	To charge branch with 15% of cost of merchandise shipped to branch		
Mar. 31	Interest on branch account	972.50	
	Branch account		972.50
	To reverse interest charge calculated on incorrect branch balance at 31 Mar 1955		
Mar. 31	Office expense	175.00	
	Branch account		175.00
	To credit branch with proceeds from sale of branch scrap material		
Mar. 31	Branch account	972.25	
	Interest on branch account		972.25
	To charge branch with correct amount of interest on branch account balance at 31 Mar 1955		

Branch books		*Dr.*	*Cr.*
1955			
Mar. 31	Building maintenance	225.00	
	Head office account		225.00
	To adjust head office account improperly charged with maintenance		
Mar. 31	Purchases	1,050.00	
	Head office account		1,050.00
	To correct charges of merchandise received from head office		
Mar. 31	Head office account	972.50	
	Interest on head office account		972.50
	To reverse interest charge calculated on incorrect balance at 31 Mar 1955		
Mar. 31	Purchases	30.00	
	Head office account		30.00
	To adjust for additional amount taken on head office credit note		
Mar. 31	Head office account	175.00	
	Miscellaneous income		175.00
	To record sale of scrap material		
Mar. 31	Head office account	600.00	
	Advertising expense		600.00
	To reverse radio advertising charged twice		
Mar. 31	Interest on head office account	972.25	
	Head office account		972.25
	To record correct amount of interest in head office account balance at 31 Mar 1955		

Editor's note: The interest entries might have been shown net at .25c on both the branch and the head office accounts.

PROBLEM 2

Final Examination, October 1955

Accounting II, Question 3 (20 marks)

R, a textile manufacturer, has come to you for advice concerning the advisability of installing a cost system in his business. He explains that it had been suggested that he would be wise to set up a cost system, since competition has become very keen and the margin of profit is low in this type of industry.

The operations of R's business are divided into two departments: the dyeing and the finishing of raw woven cloth purchased from various weaving mills. The finished products are sold to large clothing manufacturers and retail textile stores. The year-end inventories of work-in-process and finished

goods have always been determined on the basis of physical count and estimated prices.

R asks you the following questions:

(4 marks) (i) What would be the principal advantages of installing a cost system?

(2 marks) (ii) What type of cost system would be most suitable for the business? Why do you recommend this type of cost system?

(8 marks) (iii) What general additions or alterations would have to be made to the present accounting system which had been designed primarily for the purpose of preparing the annual financial statements?

(6 marks) (iv) What advantages, if any, would there be in combining a budget system with a cost system?

Required

The answers that you would give to the questions asked by R.

A SOLUTION

(a) The principal advantages of a cost system are:

1. The ascertainment of the manufacturing cost per unit of output.
2. The improvement in efficiency which is possible through comparing costs at regular intervals.
3. The additional information which is available for inventory valuations.
4. The establishment of control over production.
5. The use of cost figures in assessing the reasonableness of selling prices and methods of distribution.
6. The availability of cost figures for budgeting.

(b) Type of cost system recommended

The fact that the operations of the business take place in two distinct departments makes a *process cost system* the most appropriate type. By this method it is possible to accumulate data on material, labour, and manufacturing costs for each process. As a result, the unit cost of dyeing and the unit cost of finishing can be determined separately. The system also facilitates the valuation of work-in-process inventories.

(c) Required additions and alterations to present accounting system

1. Subsidiary cost records must be established with a Cost ledger control account set up in the general ledger.
2. All materials, labour, and factory service put into production will be charged to Cost ledger control account (or accounts) in the general ledger rather than to separate expense accounts.
3. In the subsidiary cost records the accounts will be separated as to processes. In other words, all costs of manufacturing will be classified and charged to the applicable process in the subsidary cost records.
4. Transfers will be recorded from one process to another in the subsidiary cost records as goods completely processed in one department are passed on to the next process.

5. Inventories of raw materials and finished goods may be carried in either the general ledger or the subsidiary ledger, whereas inventories of work-in-process will be picked up from the subsidiary costs records.
6. Production orders (or some controlling record) properly authorized will control the flow of production between processes.

(d) The advantages of combining a budget system with a cost system

1. Assists in coordinating production with the forecast of sales.
2. Provides better control over expenditures by reason of the preliminary planning required by the budget system and the subsequent comparison which is possible because of the availability of cost figures.
3. Facilitates the intelligent purchase of materials.
4. Assists in planning financial arrangements by making it possible to estimate cash requirements.
5. Compels, at regular intervals, a fresh consideration of markets, products, methods, and service.
6. Provides a plan for the most economical use of materials, labour, and factory service.
7. Provides a basis for the use of standard costs.
8. Permits allocation of responsibility to department heads.
9. Gives management an opportunity to study fixed asset capacity and cash requirements for expansion.

PROBLEM 3

Final Examination, October 1955

Accounting II, Question 4 (10 marks)

C, K, and T are in partnership and share profits in the ratio of 60:30:10 respectively. By agreement the books of the partnership are kept on a cash basis. Also by agreement, it is stipulated that on the death of a partner his estate will receive, in addition to his capital as per the books, a lump sum payment to represent his interest in the unrecorded net assets (representing unrecorded income) of the partnership. The lump sum payments to the estates are set at:

$30,000 in the case of C
15,000 in the case of K
5,000 in the case of T

K dies and the $15,000 is paid to his estate in addition to the other amounts payable.

Required

(5 marks) (a) What entries should be made in the partnership books to record the payment of the $15,000 and the ultimate disposal of such amount?

(2 marks) (b) If there is a life tenant and a remainderman in K's estate, which of them should be credited with the $15,000? Why?

(3 marks) (c) How should this payment of $15,000 be treated in computing the taxable incomes of the various partners?

A SOLUTION

(a) Books of C and T

	Dr.	Cr.
Capital – C	12,857.14	
Capital – T	2,142.86	
Bank		15,000.00
To record payment to estate of K for K's interest in unrecorded net assets of partnership. (Charged against capital accounts of remaining partners in ratio of profit sharing, 60:10.)		

(b) If there is a life tenant and a remainderman in K's estate, the remainderman should be credited with the $15,000. This amount represents assets of the partnership in existence at the date of K's death regardless of the fact that they were not recorded in the books of the partnership.

(c) The payment of $15,000 is income of the estate in the year in which it is received, subject to the possible relief in tax rates as provided in the Income Tax Act. Separate returns should be filed: one from the end of the previous business year to the date of K's death, and one for the period subsequent to the date of death.

The payment also effects a reduction of partnership profits in the year paid, and accordingly there would be a corresponding decrease in the taxable income of the remaining partners.

PROBLEM 4

Final Examination, October 1955

Auditing III, Question 3 (20 marks)

The management of S Co. Ltd. is concerned with the inability of the company to discharge its current obligations promptly.

The following balance sheet reflects the financial position of the S Co. Ltd. as at 31st December 1954:

S CO. LTD.

Balance Sheet
as at 31 December 1954

ASSETS

Current assets:			
Cash on hand and in bank			$ 7,000
Accounts receivable — trade		$ 420,000	
Less: Allowance for doubtful accounts		20,000	400,000
Inventories, at the lower of cost or market:			
Raw materials		$ 200,000	
Finished goods		100,000	300,000
3% Government of Canada bonds, at cost and accrued interest (quoted value $98,550)			99,900
Total current assets			$ 806,900
Fixed assets:			
Land, at cost		$ 100,000	
Buildings, at cost	$ 750,000		
Less: Accumulated depreciation	350,000	400,000	
Machinery and equipment, at cost	$1,500,000		
Less: Accumulated depreciation	800,000	700,000	1,200,000
			$2,006,900

LIABILITIES

Current liabilities:			
Accounts payable and accrued expenses			$ 406,000
Income taxes payable — estimated			100,900
Total current liabilities			$ 506,900
Shareholders' equity:			
Common shares of $100 par value each— authorized and issued 12,000 shares		$ 1,200,000	
Retained earnings:			
Balance 31 Dec 1953	$ 272,000		
Net profit for year ended 31 Dec 1954	208,000		
	$480,000		
Dividends paid	180,000	300,000	1,500,000
			$2,006,900

Additional information relating to the company's operations is as follows:

(i) The company sells to numerous clients and its terms of credit are net 30 days. The accounts receivable outstanding are aged as follows:

Current up to 30 days	$300,000
30 to 60 days	70,000
60 to 90 days	40,000
Over 90 days	10,000
	$420,000

(ii) The company purchases all of its raw material from three suppliers on credit terms of 2% 10 days, net 30 days. The accounts payable are always paid in time to take advantage of the cash discount.

(iii) The company's annual earnings have shown a small but steady increase. Profits have been largely distributed by four quarterly dividends each year and the management is most anxious not to disturb this policy.

(iv) During the year, the company's banking indebtedness was: maximum—$350,000 and minimum—nil. This was reasonably consistent with the past three years.

A, the president, feels that a temporary increase in the available cash would solve the situation. On the other hand, B, the general manager, insists that a permanent increase in working capital is essential.

Required:

Outline and comment on the various ways by which each of these objectives might be accomplished.

A SOLUTION

S CO. LTD.

Means of Effecting a Temporary Increase in Cash

1. Obtain a loan from the bank, either on an unsecured note payable or with bonds, book debts or inventories as security. A bank loan may be obtained with relatively little delay or formality, and may be paid back at will. The rate of interest on bank loans is generally fairly low.

2. Consider means of speeding up the realization of accounts receivable. It would be possible to offer cash discounts to customers who pay their accounts within, say, ten days. An alternative is to draw drafts on the customers and discount these at the bank. The use of drafts could be a temporary measure which might be discontinued at any time whereas, once established, the practice of giving cash discounts must be continued. It is conceivable that the credit terms offered to customers might be reduced without seriously affecting revenue. In any case, an inquiry should be made into the efficiency of the methods used by the credit department in collecting accounts.

3. Pay the accounts of suppliers of raw material in 30 days instead of 10 days. There are several disadvantages to this method of short-term finance. The cost of foregoing cash discounts considered as a percentage on a per annum basis, is much greater than the interest charge on a bank loan which would provide an equivalent amount of cash. The practice of delaying payments to creditors may affect the credit rating of the company and render it more difficult to obtain needed raw materials on short notice.

4. Revise the purchasing program with a view to increasing the turnover of inventory. It may be possible to institute some form of production control and so to reduce the proportion of working capital tied up in inventories.

5. Sell the Government of Canada bonds. The interest revenue sacrificed by a sale of the bonds will be less than the interest which would have to be paid on borrowed money, and it is improbable that there would be any significant capital loss on the sale.

6. Consider a revision of dividend policy. The present dividends are a high proportion of reported profits; and a reduction in the annual amount paid in dividends might be combined with a change in the dividend dates, so that the dividends would be paid only once or twice a year instead of quarterly. The dividend dates could then be set for those times in the year when the cash position of the company is normally at its best. The declaration of a stock dividend instead of a cash dividend should also be considered.

7. Use a cash budget as a means of anticipating future cash requirements.

Means of effecting a permanent increase in working capital

1. Issue debentures. This method of finance is impractical unless the additional funds required are sizable and required for a reasonably long period. The method results in a fixed charge for interest which is deductible for tax purposes.

2. Issue additional capital stock. The new capital stock may be issued by offering rights to the present shareholders or by offering the shares to the public. The shares might be either preferred or common but in either case supplementary letters patent would be required because the present authorized shares are entirely issued. If the new shares are of the same class as the existing shares, and the management feels that the dividend rate must be maintained at that which has prevailed in the past, the annual amount payable in dividends will be increased; and the cash drain caused by this increase will be greater than that which would result from interest payments on debentures.

3. Give a mortgage on the land and buildings. Unless the amount which can be borrowed by this method is large, the costs of this type of finance are likely to be large relative to the funds obtained. A mortgage loan is usually for a short term of years, and the mortgage loan may either have to be renewed at its maturity date or amortized by regular cash payments on account of principal as well as interest.

4. Sell the real estate under terms of obtaining a long-term rental contract. This method will recommend itself when the costs of operating the premises are greater than the cost of renting.

Examiner's Comments

The examiner reports that many candidates failed to distinguish adequately between a *temporary* increase in available *cash* and a *permanent* increase in *working capital*. Some candidates recommended an increase in profits as a means of increasing the available cash.

In the examiner's opinion many candidates were not sufficiently familiar with current methods of finance, and neglected to refer to the possibility of stock dividends and sale-lease-back arrangements. Many did not bring out in their answers that taking cash discounts on, for example, a 2% ten days basis is a less expensive means of financing purchases than paying 5% per annum on a bank loan. The answers submitted frequently seemed to be recitations from text books.

BY PETER C. BRIANT, B.COM., C.A.

Assistant Professor, McGill University

Current Reading

MAGAZINE ARTICLES

ACCOUNTING

"THE BREAK-EVEN CHART" by A. D. Barton. *The Australian Accountant*, September 1956, pp. 375-388.

By failing to indicate on break-even charts the limits within which the data is valid, accountants leave themselves open to criticism by economists and business management, argues the author, an Australian accountant. It is not feasible to draw a revenue function and cost function from the same origin, he writes, for revenue is seldom sufficient to cover direct costs at low levels of output. Nor does he think it is realistic to assume that revenue and cost functions may be drawn without any upper limit. With a given plant, capacity is bound to be limited by sales or production possibilities. Mr. Barton therefore urges all accountants to indicate on the charts the range over which their data is valid. Then, he says, most of the objections to the chart would be overcome.

In particular, the assumption of linear cost and revenue functions would be acceptable. Price, he states, is rarely a firm's action parameter; thus, the revenue function will rarely be curvelinear. Furthermore, it is unusual, he thinks, for a firm to increase production by increasing its variable inputs with a fixed input. Empirical data seems to indicate that increased output is usually effected while a constant proportion of fixed factor to variable factor is maintained. These considerations lead Mr. Barton to assert that the accountant's assumption of linear cost and revenue functions is reasonable in the circumstances. He nevertheless stresses that management must realize that the analysis cannot take into account every possible circumstance and that the actual relationships are rarely as clear-cut as the charts might indicate.

This is an article that has been written to correct some common misconceptions about the nature and use of break-even charts – misconceptions that apparently stem from the woefully inadequate discussions of the subject in most accounting texts. Students would be well advised to obtain a copy of this article to supplement their knowledge of the subject.

BUSINESS

"THE DEBT PROBLEM AND ECONOMIC GROWTH" by P. W. McCracken. *Michigan Business Review*. November 1956, pp. 11-15.

Despite the fact that growth in the economy is clearly revealed through balance sheets and income statements, many accountants probably feel that they are not directly concerned with the problem of economic growth. All will agree, however, that debt is something of importance. Traditionally, conservative attitudes towards debt have been maintained.

It is therefore worth noting Professor McCracken's contention that if

economic growth is to be sustained in the next decade, we must either have federal budgetary deficits or unbalanced private budgets. Furthermore, if government budgets are balanced, private debt must grow about 50% more rapidly than private income or sales to meet the financial requirements of an expanding economy. His prediction is supported by empirical data which reveals that, in the U.S. economy at any rate, there has been a fairly close relationship between the volume of total net debt and gross national product since 1916. And Professor McCracken sees no indication of a change in this relationship in the next ten years.

The only alternative, in his view, is for a larger proportion of future savings to go into equities, thereby reducing the proportion going into assets which are the debts of others. The tendency of pension funds to invest in equities and the growth of investment companies suggests some movement in this direction. On the whole, however, Professor McCracken thinks there is good reason to believe that the major financial institutions will continue to invest in bonds, mortgages, and short-term loans.

EDUCATION

"EDUCATION FOR PUBLIC ACCOUNTING" by L. L. Vance. *The Accounting Review*, October 1956, pp. 573-580.

Professor Vance, a well-known accounting teacher, reviews the major recommendations of the Commission on Standards of Education and Experience for C.P.A.'s: namely, that training for public accounting should be based primarily on university education and that education through experience should come after the successful completion of the professional examination.

According to the author, Italy has required university training with two years' experience since 1929, and the United Kingdom is moving towards emphasizing full-time university training for its professional accountants. He also records that in the United States, 74% of all candidates and 83% of the successful candidates for the May 1953 C.P.A. examinations were university graduates.

These facts, combined with the judgment of well-informed observers and the experience of the legal and medical professions, lead Vance to conclude that the Commission is eminently correct in recommending that university training be the primary preparation for practice.

Such a requirement in Canada would undoubtedly create some hardships for competent young men unable to afford the cost of university training. Vance sees no reason, however, to suggest to the majority that college education is unnecessary on this account. In fact, he points out that the ever-expanding horizons of the accounting practitioner make it increasingly necessary for him to have some understanding of social and business management problems beyond the range of purely accounting import. The solution lies, in his opinion, not in exempting the accounting student from the requirement of a university education, but in providing more financial aid through scholarships.

In considering various ways by which an embryo accountant may receive practical training, the author expresses his dislike of internship programs. There is merit in his argument that such programs tend to force upon the accounting faculty a calendar at variance with that of the rest of the

university. But an even greater disadvantage surely stems from the fact that the students on these programs generally attend classes during the summer and work in accounting firms during the busy season. The benefit derived from associating with students in other disciplines is inevitably lost. College education as a prerequisite for admission to the profession will be nothing more than a fiction unless full-time attendance on the same basis as other students is required. Then the student should be ready to write the uniform examinations within a few months after his graduation. But admission to the profession should be denied until the experience requirement has been met.

This is, in essence, the transitional goal of the U.S. Commission, and Professor Vance finds himself in complete accord with their recommendations.

FINANCE

"Trends in Canadian Corporate Financing since 1948" by J. D. Campbell and W. D. Gainer. *Cost and Management*, October 1956, pp. 343-349.

The financial policies of some 300 Canadian companies for the period 1948 to 1955 inclusive are summarized under two headings: patterns of profit utilization, and pattern of financing expenditures on fixed assets.

Dividends generally fluctuated around 50% of earnings during the period studied. The proportion of profits paid out since 1953, however, is said to have declined from 55.4% to 47.2%, despite unprecedented increases in working capital during 1955.

The increase in corporate liquidity in 1954 arose largely from a retrenchment in inventory and current liability position in an atmosphere of apprehension, according to this report. In 1955, on the other hand, the authors found a greater increase in receivables and inventories than in current liabilities. Holdings of marketable securities, in the firms studied, were also found to have increased by $240 million during 1955. On the basis of their data, the authors assert that Canadian business has never been in a better condition to unleash a record level of expenditures than it was at the start of 1956.

MANAGEMENT

"Man and Manager: An Executive Profile," by Lydia Strong. *The Management Review*, October 1956, pp. 871-887.

Of 214 senior U.S. executives participating in an A.M.A. survey, more than half consider the ability to work with people as the quality most needed by an executive. They say that human relations and the humanities are the subjects they wished they had learned more about at school.

Most of those with university training specialized in some professional or technical subject rather than the liberal arts, but less than half of them are making use of this special training at the present time. Business courses constitute an exception. Of the 56 men who prepared for business, accounting, or finance, 43 are still making use of this training. The high regard in which business and management courses are held is shown by the fact that two out of three respondents took such courses after they had finished their formal schooling, as a step in advancing their careers.

Close to one-third of the respondents began their careers in engineer-

ing and other technical fields; about a fifth started in sales; and one-sixth in accounting. These three fields accounted for more than half of the men surveyed.

RECORDS

"PROTECT YOUR RECORDS AGAINST DISASTER" by Robert A. Shiff, *Harvard Business Review*, July-August, 1956, pp. 73-84.

"WHAT MAKES UP AN ADEQUATE RECORDS PROGRAM" by William Benedon, *N.A.C.A. Bulletin*, August 1956, pp. 1504-1517.

In his column "Office and Staff Management" in the August 1956 issue of the *New York C.P.A.*, Max Block observes that "a new profession is quietly developing, namely that of records management". This point is well borne out by the two articles cited above. Of the two, Mr. Shiff's should be read first. As the title implies, he is more concerned with creating an awareness among business management of the need for record protection than with outlining the development of the program itself.

A review of the known damage to records stemming from nuclear explosions, fire, and floods leads Mr. Shiff to the conclusion that "safeguards against the twin threats of fire and water constitute the best protection now available for those records which survive attack at all . . . " Both writers agree, however, that a relatively small proportion of all records merit such protection: Mr. Shiff asserts, for example, that "truly vital records usually constitute only 1% or 2% of the total records; Mr. Benedon states that less than 5% of all records must be retained permanently.

On the determination and definition of vital records a sharp divergence in approach is apparent. Mr. Benedon would apparently take a physical inventory of all company records in both storage and active office areas, appraise the records so listed for the purpose of determining their retention value, and have operating and administrative personnel approve the retention periods recommended. From the retention schedule developed, he would then classify the records in terms of their varying degrees of importance. While conceding that the inventory is a good method for establishing a records retention schedule, Mr. Shiff believes that the possibility of records stowed away in desk drawers being omitted from the list makes it a less than completely satisfactory method for identifying vital records. He recommends instead the "functional" approach now followed by the National Records Management Council, of which he is president. Under this method, the records to be protected are identified by analyzing the major operations of the business, breaking them into basic functions, determining the information needed for the discharge of these functions, and then identifying the records which contain such information. In a separate exhibit, the vital records one might expect to find under the treasury, sales, engineering, manufacturing, and administrative functions are listed.

The most important aspect of a vital records protection program is the method of protection actually employed. Both writers discuss the principal means by which a company can accomplish this phase: dispersal (built in and designed copy), evacuation, vaulting and duplication.

How does one determine whether a company's valuable records are ade-

quately safeguarded? Mr. Shiff suggests the following approach:

> Ask yourself — at 11 a.m. some morning and at 3 p.m. the same afternoon — if a bomb struck now, if fire raced through this building, or if we were inundated, where would our valuable records be? How are they protected now? Where is our vital records storage? What provisions have we already established for reconstructing our business and re-establishing our operations?

These are questions that might well be raised by any professional accountant while in a client's office. For, as Mr. Benedon states at the close of his article, "A records program review should be an integral part of the company's regular audit program . . ."

BOOKS RECEIVED

"Reporting Foreign Operations," by Samuel R. Hepworth; Bureau of Business Research, School of Business Administration, University of Michigan, Ann Arbor; pp. 211; $3.50. [To be reviewed]

"Key to Profits Tax — 4th Edition". Taxation Publishing Company, London, W1; pp. 287; 10s. (net), 10/5d post free.

"How to Have Your Own Business and Make It Pay," by W. R. Muirath; D. Van Nostrand (Canada) Limited, Toronto 16; pp. 323; $6.95.

"The Anti-Capitalist Mentality," by Ludwig von Mises; D. Van Nostrand (Canada) Limited, Toronto 16; pp. 114; $4.50.

SELECTED READING

Controllership

"Relation of Invested Capital to Profit", by D. M. Sheehan, *The Controller,* October 1956, pp. 463 et seq.

Cost Accounting

"Significant Areas for Cost Reduction" by B. A. C. Hills. *Cost and Management,* September 1956, pp. 298-311.

"A Cost System for a Frozen Meals Manufacturer" by P. J. McCullagh. *NACA Bulletin,* October 1956, pp. 243-251.

"Unit Cost Data for Management" by F. L. Heuser. *NACA Bulletin,* September 1956, pp. 13-17.

Education

"Educational Standards for the Accountancy Profession" by N. F. Stevens. *The Australian Accountant,* May 1956, pp. 199-214.

Equipment

"Integrated Data Processing" by H. S. Brown, *Cost and Management,* September 1956, pp. 312-318.

Finance

"Growth Companies vs. Growth Stocks" by P. H. Bernstein. *Harvard Business Review,* Sept-October 1956, pp. 87-98.

Addresses of Publishers

Accounting Review, College of Commerce and Administration, Ohio State University, Columbus 10, Ohio.

[The] *Accountants Journal* (N.Z.), P.O. Box 5039, Wellington C.1., New Zealand.

American Management Association, 330 W. 42 St., New York 18, N.Y.

[The] *Australian Accountant,* 37 Queen St., Melbourne.

[The] *Chartered Accountant in Australia,* Box 3921, G.P.O., Sydney, N.S.W.

Controller, 2 Park Ave., New York 16, N.Y.

Cost and Management, 66 King St. E., Hamilton.

Harvard Business Review, Gallatin House, Soldiers Field, Boston 63, Mass.

Journal of Accountancy, 270 Madison Ave., New York 16, N.Y.

NACA Bulletin, 505 Park Ave., New York 22, N.Y.

Taxation Publishing Co. Ltd., 98 Park St., London, W1.

D. Van Nostrand (Canada) Ltd., 25 Hollinger Rd., Toronto 16.

NEWS OF OUR MEMBERS

British Columbia

A. P. Gardner & Co., Chartered Accountants, announce the admission to partnership of Douglas Pearson, C.A., Vancouver.

Frederick Field & Co., Chartered Accountants, announce the removal of their New Westminster office to 725 Carnarvon St., New Westminster.

Hancock, Keenlyside & Mylett, Chartered Accountants, announce the removal of their offices to 524 Standard Bldg., 510 West Hastings St., Vancouver.

McIntosh, McVicar, Dinsley & Co., Chartered Accountants, announce the removal of their offices to 1075 Melville St., Vancouver.

Manitoba

L. A. Bruce, C.A. has been appointed business administrator of the Protestant School Board of Greater Montreal.

J. Hopkinson, C.A., formerly an advisor to the Ministry of Finance in Addis Ababa, Ethiopia, has now returned to Canada and is residing in Victoria, B.C.

J. V. Sutton, C.A. has been appointed treasurer and controller of Scales & Roberts Ltd., Toronto.

G. A. Gislason, C.A. has been appointed treasurer of North American Lumber and Supply Co. Ltd., Winnipeg.

Nova Scotia

A. I. Barrow, C.A. has been appointed president of the Maritime Provinces Board of Trade, Halifax.

Ontario

Allen, Miles, Fox & Johnston, Chartered Accountants, announce the removal of their offices to The Commercial Travellers' Bldg., 17 Dundonald St., Toronto.

John A. McCleery, C.A. has been appointed treasurer of Green Giant of Canada Ltd., Tecumseh.

P. S. Ross & Sons, Chartered Accountants, announce the opening of an office for the practice of their profession at Crown Trust Bldg., 200 Queens Ave., London. The resident partner will be D. W. McKinnon, C.A.

P. D. Ellis, C.A. announces the removal of his office to Rm. 510, 32 Front St. W., Toronto.

Quebec

Maheu, Noel & Co., Chartered Accountants, announce the admission to partnership of Bernard Robert, C.A., Montreal.

H. Paul Nadeau, C.A. and Pierre Patenaude, C.A. announce the formation of a partnership for the practice of their profession under the firm name of Nadeau & Patenaude, Chartered Accountants, with offices at Ste. 402-403, 333 Craig St. W., Montreal.

Edward R. Rowe, C.A. has been appointed comptroller of Schering Corporation Ltd., Montreal.

Andre Mineau, C.A. has been appointed internal auditor for Canadian Marconi Co., Montreal.

Stein, Pinkus & Co., Chartered Accountants, announce the removal of their offices to Ste. 405, 6555 Cote des Neiges Rd., Montreal.

Saskatchewan

J. Arthur Kidd, C.A. of Ottawa, chief auditor for the Department of National Defence, has been made a Fellow of the Institute of Chartered Accountants of Saskatchewan.

R. I. Dunlop, C.A. has been appointed president of the Saskatoon chartered accountants for the 1956-57 year.

David A. Williams, C.A. has been appointed manager of methods and procedures of American-Standard Products (Can.) Ltd., Toronto.

INSTITUTE NOTES

HAMILTON AND DISTRICT C.A. ASSOCIATION

J. G. McEntyre, Deputy Minister of National Revenue (Taxation), addressed a joint meeting of the Hamilton and District C.A. Association and the Lawyers Club of Hamilton on November 21. Joint chairmen of the meeting were G. H. Smith, president of the C.A. Association, and Max Sauder, president of the Lawyers Club.

On November 30 the members of the association were host to their ladies at a buffet supper and dance held at the Hamilton Golf and Country Club.

ONTARIO INSTITUTE

Annual Conference 1957—Monday, June 17 and Tuesday, June 18 have been set for the second annual conference of the Institute to be held at the University of Toronto. The Program Committee under the chairmanship of H. N. Jordan has already held two meetings to prepare a program which might equal the highly successful meeting held at Queen's University in June.

Prospectuses – The third meeting under the auspices of the Committee on Practising Members Discussion Groups of Toronto held on November 27 attracted the largest attendance so far. More than 120 members heard a panel of experts under the chairmanship of J. R. M. Wilson discuss the problems of the Securities Act. The panel was composed of T. O. P. Brown, T. A. M. Hutchison, H. N. Jordan and W. L. McDonald.

Annual Supper Dance and Cabaret – Despite a change in the date from Thursday to Monday, the annual dance on November 19 attracted a record attendance of 520. The committee received many compliments on the excellent arrangements. President J. R. M. Wilson and Mrs. Wilson, Mr. and Mrs. W. I. Hetherington and Mr. M. A. Bradshaw welcomed the guests.

Cooperative Advertising – The Council has been asked whether it is appropriate for a practising member to join with the other suppliers of a client in arranging a cooperative advertisement in a public advertising medium for the client's direct benefit and for the member's own advertising. Although it is usual for the member's part in such advertisements to be limited to the usual card permitted under the rules of conduct, the practice was none the less considered undesirable by the Council. The Council therefore directed that this note be published in *The Canadian Chartered Accountant* directing members not to participate in any such advertising scheme.

N. S. STUDENTS

At the annual general meeting of the Students Association of the N. S. Institute the following officers were elected for the coming year: president, R. D. Inglis; vice-president, V. L. Taylor; secretary-treasurer, H. O. Leistina; executive members, Wm. Fong, F. C. Barter, R. J. Foster, G. L. Morash, E. J. Nichols, D. M. Collins.

Manitoba Students Year Book

In honour of its 50th anniversary, the Chartered Accountants Students Society of Manitoba has brought out an excellent 40-page year book. The contents include reports from the officers of the Association, messages from officials of the University of Manitoba and the Institute of Chartered Accountants of Manitoba and several photographs of various student activities during the past year. Congratulations to the society and to editor Bill Campbell on their achievement.

QUEBEC INSTITUTE

A dramatic presentation of our profession was given to more than 200 final year students in Montreal high schools in two "Open House" meetings held in the Institute assembly hall. The first meeting, for English speaking students, took place on November 20 and the second, for French speaking students, on November 27. Each meeting took about two hours, commencing at 4.00 p.m.

The program included, (a) a discussion of "the professional accountant", (b) a discussion of "the accountant in industry", (c) a showing of the motion picture entitled "Accountancy — The Language of Business", (d) a brief review of how to become a chartered accountant, and (e) a question and answer period. The meetings were organized by a sub-committee of the Public Relations Committee, with J. S. McKeown as chairman and André Cote as vice-chairman.

Participants of the sessions were "The Professional Accountant" — English, George P. Keeping, French, Lucient D. Viau; "The Accountant in Industry" — English, Eric L. Hamilton, French, Leo E. Boissonnault: "How to Become a Chartered Accountant" — English, C. D. Mellor, French, J. J. St. Pierre; Moderator of Question Period — English, J. S. McKeown, French, André Cote.

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"The Chartered Accountant as a Management Consultant" was the subject for discussion by a quartet of panelists at a well-attended forum for members held on December 6 in the Institute assembly hall. The panel included the following chartered accountants: R. D. Armstrong, controller, Canadian National Railways; J. E. Clubb, vice-president, finance, Canadian Car and Foundry Company Limited; J. J. Macdonnell, partner, Price Waterhouse & Co.; A. N. Steiner, resident director, J. D. Woods & Gordon Ltd. Howard I. Ross of P. S. Ross & Sons was moderator. The forum was organized by a sub-committee of the Public Relations Committee with D. H. Smith as chairman.

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A speaking marathon was conducted by Howard I. Ross, who addressed four classes at McGill University all in one morning on November 28. Classes covered in the tour included second and fourth year accounting. The presentation in each case comprised a review of the advantages of being a chartered accountant, showing of the film entitled "Accountancy — The Language of Business", and a question and answer period. The program was arranged by a sub-committee of the Public Relations Committee with D. F. Rennie as chairman.

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M. L. Bessner, C.A., a member of the Loyola College teaching staff and moderator of the Loyola Commerce Society, arranged for a showing of the film "Accountancy — The Language of Business" at the annual dinner of the society on December 12 at which the guest speaker was H. G. Norman, C.M.G., C.A., president of the Montreal Stock Exchange and the Canadian Stock Exchange.

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On November 22, a "table conference" of members of the Students' Society was held in the reception room of Molson's Brewery. Simultaneous discussions were carried on at each table under the guidance of table leaders. At the conclusion the thoughts of the gathering were reported to the meeting. The subject of the conference was how tuition of students provided by universities might be supplemented. The meeting was organized by the executive committee of the Society, with M. St. Denis as chairman.

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On the speakers platform — J. A. de Lalanne at the luncheon meeting of National Office Management Association, Montreal Chapter; D. H. Smith at the Verdun Rotary Club, subsequently in a five-minute program on radio station CFCF.

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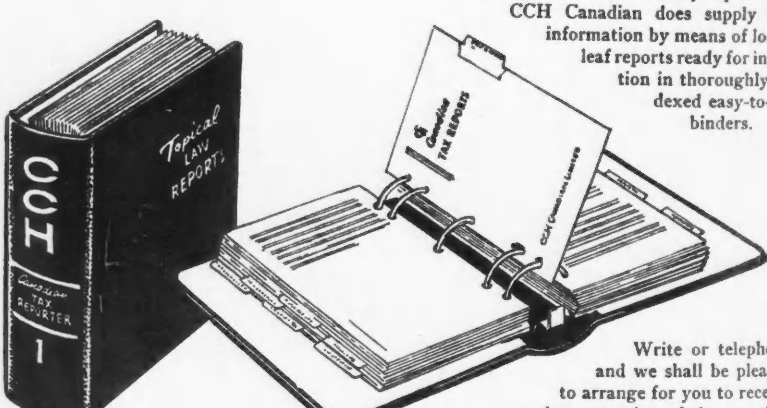

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